Legislative Proposals and Explanatory Notes Relating to Income Tax

Published by
The Honourable John Manley, P.C., M.P.
Deputy Prime Minister and Minister of Finance

December 2002

Canada

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Legislative Proposals

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INCOME TAX ACT

1. (1) Paragraph 4(3)(*a*) of the *Income Tax Act* is replaced by the following:

(*a*) subject to paragraph (*b*), all deductions permitted in computing a taxpayer's income for a taxation year for the purposes of this Part, except any deduction permitted by any of paragraphs 60(*b*) to (*o*), (*p*), (*r*) and (*v*) to (*x*), apply either wholly or in part to a particular source or to sources in a particular place; and

(2) Subsection (1) applies to the 2002 and subsequent taxation years.

2. (1) Subsection 6(15.1) of the French version of the Act is replaced by the following:

Montant remis

(15.1) Pour l'application du paragraphe (15), le « montant remis » à un moment donné sur une dette émise par un débiteur s'entend au sens qui serait donné à cette expression par le paragraphe 80(1) si, à la fois :

a) la dette était une dette commerciale, au sens du paragraphe 80(1), émise par le débiteur;

b) il n'était pas tenu compte d'un montant inclus dans le calcul du revenu en raison du règlement ou de l'extinction de la dette à ce moment;

c) il n'était pas tenu compte des alinéas *f*) et *h*) de l'élément B de la formule figurant à la définition de « montant remis » au paragraphe 80(1);

d) il n'était pas tenu compte des alinéas 80(2)*b*) et *q*).

(2) Subsection (1) applies to taxations years that end after February 21, 1994.

3. (1) The portion of subsection 7(7) of the Act before the definition "qualifying person" is replaced by the following:

Definitions

(7) The following definitions apply in this section and in subsection 47(3), paragraphs 53(1)(*j*), 110(1)(*d*) and (*d*.01) and subsections 110(1.5) to (1.8) and (2.1).

(2) Subsection (1) applies after 1998, except that

(*a*) it does not apply to a right under an agreement to which subsection 7(7) of the Act, as enacted by subsection 3(7) of chapter 22 of the Statutes of Canada, 1999, does not (except for the purpose of applying paragraph 7(3)(*b*) of the Act) apply; and

(*b*) before 2000, the portion of subsection 7(7) of the Act, as enacted by subsection (1), before the definition "qualifying person" is to be read as follows:

(7) The definitions in this subsection apply in this section and in paragraph 110(1)(*d*) and subsections 110(1.5) to (1.8).

4. (1) Paragraph 8(1)(*b*) of the Act is replaced by the following:

Legal expenses of employee

(*b*) amounts paid by the taxpayer in the year as or on account of legal expenses incurred by the taxpayer to collect, or to establish a right to, an amount owed to the taxpayer that, if received by the taxpayer, would be required by this subdivision to be included in computing the taxpayer's income;

(2) The portion of paragraph 8(1)(*i*) of the Act before subparagraph (i) is replaced by the following:

Dues and other expenses of performing duties

(*i*) an amount paid by the taxpayer in the year, or on behalf of the taxpayer in the year if the amount paid on behalf of the taxpayer is required to be included in the taxpayer's income for the year, as

(3) Subsection (1) applies to amounts paid in the 2001 and subsequent taxation years.

5. (1) Paragraph 12(1)(*o*) of the Act is replaced by the following:

Royalties, etc.

(*o*) any amount (other than a prescribed amount and an amount referred to in paragraph 18(1)(*m*))

(i) that became receivable in the year by

(A) Her Majesty in right of Canada or of a province,

(B) an agent of Her Majesty in right of Canada or of a province, or

(C) a corporation, a commission or an association that is controlled by Her Majesty in right of Canada or of a province or by an agent of Her Majesty in right of Canada or of a province, and

(ii) that can reasonably be considered to be a royalty, tax (other than a tax or portion of a tax that can reasonably be considered to be a municipal or school tax), lease rental or bonus, however described, or to be in respect of the late receipt or non-receipt of any of those amounts, in relation to

(A) the acquisition, development or ownership of a Canadian resource property of the taxpayer, or

(B) the production in Canada

(I) of petroleum, natural gas or related hydrocarbons from a natural accumulation of petroleum or natural gas (other than a mineral resource) located in Canada, or from an oil or gas well located in Canada, in respect of which the taxpayer had an interest,

(II) of sulphur from a natural accumulation of petroleum or natural gas located in Canada, from an oil or gas well located in Canada or from a mineral resource located in Canada, in respect of which the taxpayer had an interest,

(III) to any stage that is not beyond the prime metal stage or its equivalent, of metal, minerals (other than iron or petroleum or related hydrocarbons) or coal from a mineral resource located in Canada in respect of which the taxpayer had an interest,

(IV) to any stage that is not beyond the pellet stage or its equivalent, of iron from a mineral resource located in Canada in respect of which the taxpayer had an interest, or

(V) to any stage that is not beyond the crude oil stage or its equivalent, of petroleum or related hydrocarbons from a deposit located in Canada of bituminous sands or oil shales in respect of which the taxpayer had an interest;

(2) Section 12 of the Act is amended by adding the following after subsection (2):

No deferral of section 9 income under paragraph (1)(*g*)

(2.01) Paragraph (1)(*g*) does not defer the inclusion in income of any amount that would, if this section were read without reference to that paragraph, be included in computing the taxpayer's income in accordance with section 9.

(3) Subsection (1) applies to amounts that become receivable after ANNOUNCEMENT DATE.

6. (1) Subsection 13(1) of the Act is replaced by the following:

Recaptured depreciation

13. (1) If, at the end of a taxation year, the total of the amounts determined for E to K in the definition "undepreciated capital cost" in subsection (21) in respect of a taxpayer's depreciable property of a particular prescribed class exceeds the total of the amounts determined for A to D.1 in that definition in respect of that property, the excess shall be included in computing the taxpayer's income of the year.

(2) Clause 13(4)(*c*)(ii)(A) of the Act replaced by the following:

(A) if the former property is described in paragraph (*a*), before the later of the end of the second taxation year following the initial year and 24 months after the end of the initial year, or

(3) Clause 13(4)(*c*)(ii)(B)of the Act is replaced by the following.

(B) in any other case, before the later of the end of the first taxation year following the initial year and 12 months after the end of the initial year,

(4) Section 13 of the Act is amended by adding the following after subsection (4.1):

Election – limited period franchise, concession or license

(4.2) Subsection (4.3) applies in circumstances where (*a*) a taxpayer (in this subsection and subsection (4.3) referred to as the "transferor") has, pursuant to a written agreement with a person or partnership (in this subsection and subsection (4.3) referred to as the "transferee"), at any time disposed of or terminated a former property that is a franchise, concession or licence for a limited period that is wholly attributable to the carrying on of a business at a fixed place;

(*b*) the transferee acquired the former property from the transferor or, on the termination, acquired a similar property in respect of the same fixed place from another person or partnership; and

(*c*) the transferor and the transferee jointly elect in their returns of income for their taxation years that include that time to have subsection (4.3) apply in respect of the acquisition and the disposition or termination.

Effect of election

(4.3) Where this subsection applies in respect of an acquisition and a disposition or termination,

(*a*) if the transferee acquired a similar property referred to in paragraph (4.2)(*b*), the transferee is deemed to have also acquired the former property at the time that the former property was terminated and to own the former property until the transferee no longer owns the similar property;

(*b*) if the transferee acquired the former property referred to in paragraph (4.2)(*b*), the transferee is deemed to own the former property until such time as the transferee owns neither the former property nor a similar property in respect of the same fixed place to which the former property related;

(*c*) for the purpose of calculating the amount deductible under paragraph 20(1)(*a*) in respect of the former property in computing the transferee's income, the life of the former property remaining on its acquisition by the transferee is deemed to be equal to the period that was the life of the former property remaining on its acquisition by the transferor; and

(*d*) any amount that would, if this Act were read without reference to this subsection, be an eligible capital amount to the transferor or an eligible capital expenditure to the transferee in respect of the disposition or termination of the former property by the transferor is deemed to be

(i) neither an eligible capital amount nor an eligible capital expenditure,

(ii) an amount required to be included in computing the capital cost to the transferee of the former property, and

(iii) an amount required to be included in computing the proceeds of disposition to the transferor in respect of a disposition of the former property.

(5) Subsection (1) applies to taxation years that end after February 23, 1998.

(6) Subsection (2) applies in respect of dispositions that occur in taxation years that end ON OR AFTER THE DAY THAT IS 24 MONTHS BEFORE ANNOUNCEMENT DATE.

(7) Subsection (3) applies in respect of dispositions that occur in taxation years that end ON OR AFTER THE DAY THAT IS 12 MONTHS BEFORE ANNOUNCEMENT DATE.

(8) Subsection (4) applies in respect of dispositions and terminations that occur after ANNOUNCEMENT DATE.

7. (1) The portion of subsection 14(1.01) of the Act before paragraph (*c*) is replaced by the following:

Election re capital gain

(1.01) A taxpayer may, in the taxpayer's return of income for a taxation year, elect that the following rules apply to a disposition made at any time in the year of an eligible capital property (other than goodwill) in respect of a business, if the taxpayer's actual proceeds of the disposition exceed the taxpayer's eligible capital expenditure in respect of the acquisition of the property, that eligible capital expenditure can be determined and, for taxpayers who are individuals, the taxpayer's exempt gains balance in respect of the business for the year is nil:

(*a*) for the purpose of subsection (5) other than the description of A in the definition "cumulative eligible capital", the proceeds of disposition of the property are deemed to be equal to the amount of that eligible capital expenditure;

(*b*) the taxpayer is deemed to have disposed at that time of a capital property that had, immediately before that time, an adjusted cost base to the taxpayer equal to the amount of that eligible capital expenditure, for proceeds of disposition equal to the actual proceeds; and

(2) Paragraph 14(3)(*a*) of the Act is replaced by the following:

(*a*) the amount determined for E in the definition "cumulative eligible capital" in subsection (5) in respect of the disposition of the property by the transferor or, if the property is the subject of an election under subsection (1.01) by the transferor, 3/4 of the actual proceeds referred to in that subsection,

(3) The description of A in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:

A is the amount, if any, by which 3/4 of the total of all eligible capital expenditures in respect of the business made or incurred by the taxpayer after the taxpayer's adjustment time and before that time exceeds the total of all amounts each of which is determined by the formula

$$1/2 \times (A.1 - A.2) \times (A.3/A.4)$$

where

A.1 is the amount required, because of paragraph (1)(*b*) or 38(*a*), to be included in the income of a person or partnership (in this definition referred to as the "transferor") not dealing at arm's length with the taxpayer in respect of the disposition after ANNOUNCEMENT DATE of a property that was an eligible capital property acquired by the taxpayer directly or indirectly, in any manner whatever, from the transferor and not disposed of by the taxpayer before that time,

A.2 is the total of all amounts that can reasonably be considered to have been claimed as deductions under section 110.6 by the transferor in respect of that disposition,

A.3 is the transferor's proceeds from that disposition, and

A.4 is the transferor's total proceeds of disposition of eligible capital property in the taxation year of the transferor in which the property described in A.1 was disposed of,

(4) The description of R in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:

R is the total of all amounts each of which is an amount included, in computing the taxpayer's income from the business for a taxation year that ended before that time and after the taxpayer's adjustment time

(*a*) in the case of a taxation year that ends after February 27, 2000, under paragraph (1)(*a*), or

(*b*) in the case of a taxation year that ended before February 28, 2000,

(i) under subparagraph (1)(*a*)(iv), as that subparagraph applied in respect of that taxation year, or

(ii) under paragraph (1)(*b*), as that paragraph applied in respect of that taxation year, to the extent that the amount so included is in respect of an amount included in the amount determined for P;

(5) The portion of subsection 14(6) of the Act before paragraph (*a*) is replaced by the following:

Exchange of property

(6) If in a taxation year (in this subsection referred to as the "initial year") a taxpayer disposes of an eligible capital property (in this section referred to as the taxpayer's "former property") and the taxpayer so elects under this subsection in the taxpayer's return of income for the year in which the taxpayer acquires an eligible capital property that is a replacement property for the taxpayer's former property, the amount, not exceeding the amount that would otherwise be included in the amount determined for E in the definition "cumulative eligible capital" in subsection (5) (if the description of E in that definition were read without reference to "3/4 of") in respect of a business, that has been used by the taxpayer to acquire the replacement property before the later of the end of the first taxation year after the initial year and 12 months after the end of the initial year

(6) Subsection (1) applies to dispositions of eligible capital property that occur in taxation years that end after February 27, 2000 except that, in its application to those dispositions of eligible capital property that occur before [ANNOUNCEMENT DATE +1], the portion of subsection 14(1.01) of the Act before paragraph (*c*), as enacted by subsection (1), is to be read as follows:

(1.01) A taxpayer may, in the taxpayer's return of income for a taxation year, elect that the following rules apply to a disposition made at any time in the year of an eligible capital property (other than goodwill) in respect of a business, if the taxpayer's actual proceeds of the disposition exceed the taxpayer's cost of the property, that cost can be determined and, for taxpayers who are individuals, the taxpayer's exempt gains balance in respect of the business for the year is nil:

(*a*) for the purposes of subsection (5), the proceeds of disposition of the property are deemed to be equal to that cost;

(*b*) the taxpayer is deemed to have disposed at that time of a capital property that had, immediately before that time, an adjusted cost base to the taxpayer equal to that cost, for proceeds of disposition equal to the actual proceeds; and

(7) Subsections (2) to (4) apply to taxation years that end after February 27, 2000.

(8) Subsection (5) applies in respect of dispositions that occur in taxation years that end ON OR AFTER THE DAY THAT IS 12 MONTHS BEFORE ANNOUNCEMENT DATE.

8. (1) Subsection 15(1.21) of the French version of the Act is replaced by the following:

Montant remis

(1.21) Pour l'application du paragraphe (1.2), le « montant remis » à un moment donné sur une dette émise par un débiteur s'entend au sens qui serait donné à cette expression par le paragraphe 80(1) si, à la fois :

a) la dette était une dette commerciale, au sens du paragraphe 80(1), émise par le débiteur;

b) il n'était pas tenu compte d'un montant inclus dans le calcul du revenu (autrement que par l'effet de l'alinéa 6(1)*a*)) en raison du règlement ou de l'extinction de la dette;

c) il n'était pas tenu compte des alinéas *f*) et *h*) de l'élément B de la formule figurant à la définition de « montant remis » au paragraphe 80(1);

d) il n'était pas tenu compte des alinéas 80(2)*b*) et *q*).

(2) Subsection 15(2) of the French version of the Act is replaced by the following:

Dette d'un actionnaire

(2) La personne ou la société de personnes – actionnaire d'une société donnée, personne ou société de personnes rattachée à un tel actionnaire ou associé d'une société de personnes, ou bénéficiaire d'une fiducie, qui est un tel actionnaire – qui, au cours d'une année d'imposition, obtient un prêt ou devient la débitrice de la société donnée, d'une autre société liée à celle-ci ou d'une société de personnes dont la société donnée ou une société liée à celle-ci est un associé, est tenue d'inclure le montant du prêt ou de la dette dans le calcul de son revenu pour l'année. Le présent paragraphe ne s'applique pas aux sociétés résidant au Canada ni aux sociétés de personnes dont chacun des associés est une société résidant au Canada.

(3) Subsection (1) applies to taxation years that end after February 21, 1994.

(4) Subsection (2) applies to loans made and indebtedness arising in the 1990 and subsequent taxation years.

9. (1) Section 17 of the Act is amended by adding the following after subsection (8):

Borrowed money

(8.1) Subsection (8.2) applies in respect of money (referred to in this subsection and in subsection (8.2) as "new borrowings") that a controlled foreign affiliate of a particular corporation resident in Canada has borrowed from the particular corporation where the affiliate has used the new borrowings

(*a*) to repay money (referred to in this subsection and in subsection (8.2) as "previous borrowings") previously borrowed from any person or partnership, if

(i) the previous borrowings became owing after the last time that the affiliate became a controlled foreign affiliate of the particular corporation, and

(ii) the previous borrowings have, at all times after they became owing, been used for a purpose described in subparagraph (8)(*a*)(i) or (ii); or

(*b*) to pay an amount owing (referred to in this subsection and in subsection (8.2) as the "unpaid purchase price") by the affiliate for property previously acquired from any person or partnership, if

(i) the property was purchased, and the unpaid purchase price became payable, by the affiliate after the last time that it became a controlled foreign affiliate of the particular corporation, or

(ii) the unpaid purchase price is in respect of property that, at all times after the unpaid purchase price became payable by the affiliate, was property that had been used principally to earn income described in clause (8)(*a*)(i)(A) or (B).

Deemed use

(8.2) If this subsection applies in respect of new borrowings, the new borrowings are, for the purpose of subsection (8), deemed to have been used for the purpose for which the proceeds from the previous borrowings were used or were deemed by this subsection to have been used, or to acquire the property in respect of which the unpaid purchase price was payable, as the case may be.

(2) Subsection (1) applies to taxation years that begin after February 23, 1998.

10. (1) Paragraph 18(1)(*m*) of the Act is replaced by the following:

Royalties, etc.

(*m*) any amount (other than a prescribed amount)

(i) that is paid or payable in the year to

(A) Her Majesty in right of Canada or of a province,

(B) an agent of Her Majesty in right of Canada or of a province, or

(C) a corporation, a commission or an association that is controlled by Her Majesty in right of Canada or of a province or by an agent of Her Majesty in right of Canada or of a province, and

(ii) that can reasonably be considered to be a royalty, tax (other than a tax or portion of a tax that can reasonably be considered to be a municipal or school tax), lease rental or bonus, however described, or to be in respect of the late payment or non-payment of any of those amounts, in relation to

(A) the acquisition, development or ownership of a Canadian resource property, or

(B) the production in Canada

(I) of petroleum, natural gas or related hydrocarbons from a natural accumulation of petroleum or natural gas (other than a mineral resource) located in Canada, or from an oil or gas well located in Canada,

(II) of sulphur from a natural accumulation of petroleum or natural gas located in Canada, from an oil or gas well located in Canada or from a mineral resource located in Canada,

(III) to any stage that is not beyond the prime metal stage or its equivalent, of metal, minerals (other than iron or petroleum or related hydrocarbons) or coal from a mineral resource located in Canada,

(IV) to any stage that is not beyond the pellet stage or its equivalent, of iron from a mineral resource located in Canada, or

(V) to any stage that is not beyond the crude oil stage or its equivalent, of petroleum or related hydrocarbons from a deposit located in Canada of bituminous sands or oil shales;

(2) Paragraph 18(14)(*c*) of the Act is replaced by the following:

(*c*) the disposition is not a disposition that is deemed to have occurred by section 70, subsection 104(4), section 128.1, paragraph 132.2(3)(*a*) or (*c*) or subsection 138(11.3) or 149(10);

(3) Subsection (1) applies to amounts that are paid or become payable after ANNOUNCEMENT DATE.

(4) Subsection (2) applies to dispositions that occur after 1998.

11. (1) Subsection 18.1(15) of the Act is replaced by the following:

Non-application –
risks ceded between
insurers

(15) Subsections (2) to (13) do not apply to a taxpayer's matchable expenditure in respect of a right to receive production if

(*a*) the expenditure is in respect of commissions, or other expenses, related to the issuance of an insurance policy for which all or a portion of a risk has been ceded to the taxpayer; and (*b*) the taxpayer and the person to whom the expenditure is made, or is to be made, are both insurers who are subject to the supervision of

(i) the Superintendent of Financial Institutions, if the taxpayer or that person, as the case may be, is an insurer who is required by law to report to the Superintendent of Financial Institutions, or

(ii) the Superintendent of Insurance, or other similar officer or authority, of the province under whose laws the insurer is incorporated, in any other case.

Exception

(16) Subsections (2) to (13) do not apply to a taxpayer's matchable expenditure in respect of a right to receive production if

(*a*) no portion of the matchable expenditure can reasonably be considered to have been paid to another taxpayer, or to a person or partnership with whom the other taxpayer does not deal at arm's length, to acquire the right from the other taxpayer;

(*b*) no portion of the matchable expenditure can reasonably be considered to relate to a tax shelter or a tax shelter investment (within the meaning assigned by subsection 143.2(1)); and

(*c*) none of the main purposes for making the matchable expenditure can reasonably be considered to have been to obtain a tax benefit for the taxpayer, a person or partnership with whom the taxpayer does not deal at arm's length, or a person or partnership that holds, directly or indirectly, an interest in the taxpayer.

Revenue exception

(17) Paragraph (4)(*a*) does not apply in determining the amount for a taxation year that may be deducted in respect of a taxpayer's matchable expenditure in respect of a right to receive production if

(*a*) before the end of the taxation year in which the matchable expenditure is made, the total of all amounts each of which is included in computing the taxpayer's income for the year (other than any portion of any of those amounts that is the subject of a reserve claimed by the taxpayer for the year under this Act) in respect of the right to receive production that relates to the matchable expenditure exceeds 80% of the matchable expenditure;

(*b*) no portion of the matchable expenditure can reasonably be considered to have been paid to another taxpayer, or to a person or partnership with whom the other taxpayer does not deal at arm's length, to acquire the right from the other taxpayer; and

(*c*) neither subsection (15) nor (16) applies in respect of the matchable expenditure.

(2) Subject to subsection (3), subsection (1) applies in respect of expenditures made by a taxpayer on or after September 18, 2001 in respect of a right to receive production, except if

(*a*) the expenditure was

(i) required to be made under a written agreement made by the taxpayer before September 18, 2001,

(ii) made under, or described in, the terms of a prospectus, preliminary prospectus or registration statement that was, before September 18, 2001, filed with a public authority in Canada in accordance with the securities legislation of Canada or of a province and, if required by law, accepted for filing by the public authority before September 18, 2001, or

(iii) made under, or described in, the terms of an offering memorandum distributed as part of an offering of securities if

(A) the memorandum contains a complete, or substantially complete, description of the securities contemplated in the offering as well as the terms and conditions of the offering,

(B) the memorandum was distributed before September 18, 2001,

(C) solicitations in respect of a sale of the securities contemplated in the offering were made before September 18, 2001, and

(D) the sale of the securities contemplated in the offering was substantially in accordance with the memorandum;

(*b*) the expenditure was made before 2002;

(*c*) the expenditure was made in consideration for services that were rendered in Canada before 2002 in respect of an activity, or a business, all or substantially all of which was carried on in Canada;

(*d*) there is no agreement, or other arrangement, under which the obligation of any taxpayer in respect of the expenditure can, on or after September 18, 2001 be changed, reduced or waived if there is a change to, or an adverse assessment under, the Act;

(*e*) if the right to receive production is, or is related to, a tax shelter investment, a tax shelter identification number in respect of the tax shelter was obtained before September 18, 2001; and

(*f*) if the expenditure was made under, or described in, the terms of a document that is a prospectus, a preliminary prospectus, a registration statement or an offering memorandum (and regardless of whether the expenditure was also made under a written agreement)

(i) all of the funds raised pursuant to the document that may reasonably be used to make a matchable expenditure were received by the taxpayer before 2002,

(ii) all or substantially all of the securities distributed pursuant to the document for the purpose of raising the funds described in subparagraph (i) were acquired before 2002 by a person who is not

(A) a promoter, or an agent of a promoter, of the securities, other than an agent of the promoter who acquired the security as principal and not for resale,

(B) a vendor of the right to receive production,

(C) a broker or dealer in securities, other than a person who acquired the security as principal and not for resale, or

(D) a person who does not deal at arm's length with a person to whom clause (A) or (B) applies, and

(iii) all or substantially all of the funds raised pursuant to the document before 2002 were used to make expenditures that were required to be made pursuant to agreements in writing made before September 18, 2001.

(3) Subsection (1) does not apply to an expenditure made by a taxpayer in respect of a right to receive production in respect of a particular film or video production if

(*a*) expenditures in respect of the particular film or video production

(i) were made before September 18, 2001 (as determined, for the purpose of this paragraph, without reference to subsection 143.2(10) of the Act, except if a repaid amount for the purposes of that subsection is paid after 2002), or

(ii) were required to be made by the taxpayer under a written agreement made before September 18, 2001 by the taxpayer;

(*b*) principal photography of the particular film or video production

(i) began before 2002,

(ii) was primarily completed before April 2002, and

(iii) was conducted primarily in Canada;

(*c*) the expenditure

(i) was made before April 2002 in the course of the taxpayer's business of providing film production services in respect of the particular film or video production (as determined for the purpose of this subparagraph without reference to subsection 143.2(10) of the Act, except to the extent that a repaid amount for the purposes of that subsection is paid after 2002)

(ii) was made under, or described in, the terms of

(A) a prospectus, preliminary prospectus or registration statement that was, before September 18, 2001, filed with a public authority in Canada in accordance with the securities legislation of Canada or of a province and, if required by law, accepted for filing by the public authority before September 18, 2001, or

(B) an offering memorandum distributed as part of an offering of securities if

(I) the memorandum contains a complete, or substantially complete, description of the securities contemplated in the offering as well as the terms and conditions of the offering,

(II) the memorandum was distributed before September 18, 2001,

(III) solicitations in respect of a sale of the securities contemplated in the offering have been made before September 18, 2001, and

(IV) the sale of the securities contemplated in the offering was substantially in accordance with the memorandum, and

(iii) was not an amount in respect of advertising, marketing, promotion or market research;

(*d*) except where the particular film or video production is a designated production of the taxpayer, at least 75% of the total of all expenditures, each of which is an expenditure made by the taxpayer in the course of the business referred to in subparagraph (*c*)(i), is an expenditure described for the purpose of that subparagraph made in consideration for the supply of goods or services that are rendered or supplied in Canada before April 2002 by persons that are subject to tax on the expenditure under Part I or XIII of the Act;

(*e*) there is no agreement, or other arrangement, under which the obligation of any taxpayer to acquire a security distributed pursuant to the prospectus, preliminary prospectus, registration statement or offering memorandum can, after September 18, 2001, be changed, reduced or waived if there is a change to, or an adverse assessment under, the Act;

(*f*) if the right to receive production is, or is related to, a tax shelter investment, a tax shelter identification number in respect of the tax shelter was obtained before September 18, 2001;

(*g*) all of the funds raised pursuant to the prospectus, preliminary prospectus, registration statement or offering memorandum that may reasonably be used to make a matchable expenditure before April 2002 in respect of the particular film or video production are received by the taxpayer before 2003;

(*h*) all of the securities distributed pursuant to the prospectus, preliminary prospectus, registration statement or offering memorandum for the purpose of raising the funds described in paragraph (*g*) were acquired before 2002;

(*i*) all or substantially all of the securities distributed pursuant to the prospectus, preliminary prospectus, registration statement or offering memorandum for the purpose of raising the funds described in paragraph (*g*) were acquired by a person who is not

(i) a promoter, or an agent of a promoter, of the securities, other than an agent of the promoter who acquired the security as principal and not for resale,

(ii) a vendor of the right to receive production,

(iii) a broker or dealer in securities, other than a person who acquired the security as principal and not for resale, or

(iv) a person who does not deal at arm's length with a person referred to in subparagraph (i) or (ii); and

(*j*) except where the particular film or video production is a designated production of the taxpayer, all or substantially all of the matchable expenditures made by the taxpayer that are wholly attributable to the principal photography of the particular film or video production are wholly attributable to principal photography conducted in Canada.

(4) For the purpose of paragraphs (3)(*d*) and (*j*), a designated production of a taxpayer is

(*a*) a film or video production in respect of which

(i) all of the expenditures made by the taxpayer in respect of the particular film or video production were required to be made under a written agreement made by the taxpayer before September 18, 2001,

(ii) if the taxpayer is a partnership,

(A) the taxpayer's expenditures in respect of the particular film or video production were funded, in whole or in part, with funds raised from the initial contribution of capital of members of the taxpayer, pursuant to subscriptions in writing for the issue of units in the taxpayer,

(B) all or substantially all of those written subscriptions were received by the taxpayer on or before September 18, 2001,

(C) at least one member of the taxpayer referred to in subparagraph (i) is a partnership (in this subsection referred to as a "master partnership"),

(D) the subscriptions in writing of all master partnerships for units in the taxpayer were funded, in whole or in part, with funds raised from the initial contribution of capital of

members of the master partnerships, pursuant to subscriptions in writing for the issue of units in the master partnerships, and

(E) all or substantially all of the subscriptions in writing referred to in clause (D) were received by the master partnership on or before September 18, 2001,

(iii) if a member of a particular master partnership is a partnership (in this subsection referred to as an "original master partnership"),

(A) the subscriptions in writing of all original master partnerships for units in the particular master partnership were funded, in whole or in part, with funds raised from the initial contribution of capital of members of the original master partnerships, pursuant to subscriptions in writing for the issue of units in the original master partnerships, and

(B) all or substantially all of those written subscriptions were received by the original master partnership on or before September 18, 2001, and

(iv) no member of an original master partnership is a partnership, an interest in which is a tax shelter; or

(*b*) a film or video production in respect of which

(i) principal photography was all or substantially all complete before September 18, 2001; and

(ii) all or substantially all of the taxpayer's expenditures were made on or before September 18, 2001 (as determined, for the purpose of this paragraph, without reference to subsection 143.2(10) of the Act, except if a repaid amount for the purposes of that subsection is paid after 2002).

12. (1) Subsection 20(8) of the Act is amended by striking out the word "or" at the end of paragraph (*a*) and by adding the following after paragraph (*b*):

(*c*) the purchaser of the property sold was a corporation that, immediately after the sale,

(i) was controlled, directly or indirectly, in any manner whatever, by the taxpayer,

(ii) was controlled, directly or indirectly, in any manner whatever, by a person or group of persons that controlled the taxpayer, directly or indirectly, in any manner whatever, or

(iii) controlled the taxpayer, directly or indirectly, in any manner whatever; or

(*d*) the purchaser of the property sold was a partnership in which the taxpayer was, immediately after the sale, a majority interest partner.

(2) Subsection 20(12) of the Act is replaced by the following:

Foreign non-business income tax

(12) In computing the income of a taxpayer who is resident in Canada at any time in a taxation year from a business or property for the year, there may be deducted any amount that the taxpayer claims that does not exceed the non-business income tax paid by the taxpayer for the year to the government of a country other than Canada (within the meaning assigned by subsection 126(7) read without reference to paragraphs (*c*) and (*e*) of the definition "non-business income tax" in that subsection) in respect of that income, other than any of those taxes paid that can, in whole or in part, reasonably be regarded as having been paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation.

(3) Paragraph 20(16)(*a*) of the Act is replaced by the following:

(*a*) the total of all amounts used to determine A to D.1 in the definition "undepreciated capital cost" in subsection 13(21) in respect of a taxpayer's depreciable property of a particular class exceeds the total of all amounts used to determine E to K in that definition in respect of that property, and

(4) Subsection 20(16.1) of the Act is replaced by the following:

Non-application of subsection (16)

(16.1) Subsection (16) does not apply

(*a*) in respect of a passenger vehicle of a taxpayer that has a cost to the taxpayer in excess of $20,000 or such other amount as is prescribed; and (*b*) in respect of a taxation year in respect of a property that was a former property deemed by paragraph 13(4.3)(*a*) or (*b*) to be owned by the taxpayer, if

(i) within 24 months after the taxpayer last owned the former property, the taxpayer or a person not dealing at arm's length with the taxpayer acquires a similar property in respect of the same fixed place to which the former property applied, and

(ii) at the end of the taxation year, the taxpayer or the person owns the similar property or another similar property in respect of the same fixed place to which the former property applied.

(5) Subsection (1) applies to sales that occur after ANNOUNCEMENT DATE.

(6) Subsection (2) applies after ANNOUNCEMENT DATE in respect of taxes paid at any time.

(7) Subsection (3) applies to taxation years that end after February 23, 1998.

(8) Subsection (4) applies in respect of taxation years that end after ANNOUNCEMENT DATE.

13. (1) Subclause 37(8)(*a*)(ii)(B)(V) of the Act is replaced by the following:

(V) the cost of materials consumed or transformed in the prosecution of scientific research and experimental development in Canada, or

(2) Subsection (1) applies to costs incurred after February 23, 1998.

14. (1) The Act is amended by adding the following after section 38:

Allocation of gain re certain gifts

38.1 If a taxpayer is entitled to an amount of an advantage in respect of a gift of property described in paragraph 38(*a*.1) or (*a*.2),

(*a*) those paragraphs apply only to that proportion of the taxpayer's capital gain in respect of the gift that the eligible amount of the gift is of the taxpayer's proceeds of disposition in respect of the gift; and (*b*) paragraph 38(*a*) applies to the extent that the taxpayer's capital gain in respect of the gift exceeds the amount of the capital gain to which paragraph 38(*a*.1) or (*a*.2) applies.

(2) Subsection (1) applies to gifts made after ANNOUNCEMENT DATE.

15. (1) Paragraph 40(1.01)(*c*) of the Act is replaced by the following:

(*c*) the amount that the taxpayer claims in prescribed form filed with the taxpayer's return of income for the particular year, not exceeding the eligible amount of the gift, where the taxpayer is not deemed by subsection 118.1(13) to have made a gift of property before the end of the particular year as a consequence of a disposition of the security by the donee or as a consequence of the security ceasing to be a non-qualifying security of the taxpayer before the end of the particular year.

(2) Paragraph 40(2)(*a*) of the Act is amended by striking out the word "or" at the end of subparagraph (i), by adding the word "or" at the end of subparagraph (ii), and by adding the following after subparagraph (ii):

(iii) the purchaser of the property sold is a partnership in which the taxpayer was, immediately after the sale, a majority interest partner;

(3) Paragraph 40(3.14)(*a*) of the English version of the Act is replaced by the following:

(*a*) by operation of any law governing the partnership arrangement, the liability of the member as a member of the partnership is limited (except by operation of a provision of a statute of Canada or a province that limits the member's liability only for debts, obligations and liabilities of the partnership, or any member of the partnership, arising from negligent acts or omissions, from misconduct or from fault of another member of the partnership or an employee, an agent or a representative of the partnership in the course of the partnership business while the partnership is a limited liability partnership);

(4) Paragraph 40(3.5)(*b*) of the Act is replaced by the following:

(*b*) a share of the capital stock of a corporation that is acquired in exchange for another share in a transaction is deemed to be a property that is identical to the other share if

(i) section 51, 86, or 87 applies to the transaction, or

(ii) the following conditions are met:

(A) section 85.1 applies to the transaction,

(B) subsection (3.4) applied to a prior disposition of the other share, and

(C) none of the times described in any of subparagraphs (3.4)(*b*)(i) to (v) has occurred in respect of the prior disposition.

(5) Subsection (1) applies to gifts made after ANNOUNCEMENT DATE.

(6) Subsection (2) applies to sales that occur after ANNOUNCEMENT DATE.

(7) Subsection (3) applies after June 20, 2001.

(8) Subsection (4) applies to dispositions of property that occur after April 26, 1995, except that it does not apply to any of those dispositions by a person or partnership that occurred before 1996 and that is described in subsection 247(1) of the *Income Tax Amendments Act, 1997* unless the person or partnership, as the case may be, made a valid election under subsection 247(2) of that Act.

16. (1) The portion of subsection 43(2) of the Act before the formula in paragraph (*a*) is replaced by the following:

Ecological gifts

(2) For the purposes of subsection (1) and section 53, where at any time a taxpayer disposes of a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude, in circumstances where subsection 110.1(5) or 118.1(12) applies,

(*a*) the portion of the adjusted cost base to the taxpayer of the land immediately before the disposition that can reasonably be regarded as attributable to the covenant, easement or real servitude, as the case may be, is deemed to be equal to the amount determined by the formula

(2) Subsection (1) applies to gifts made after ANNOUNCEMENT DATE.

17. (1) The portion of subsection 43.1(1) of the Act before paragraph (*a*) is replaced by the following:

Life estates in real property

43.1 (1) Notwithstanding any other provision of this Act, if at any time a taxpayer disposes of a remainder interest in real property (except as a result of a transaction to which subsection 73(3) would otherwise apply or by way of a gift to a donee described in the definition "total charitable gifts", "total Crown gifts" or "total ecological gifts" in subsection 118.1(1)) to a person or partnership and retains a life estate or an estate *pur autre vie* (in this section called the "life estate") in the property, the taxpayer is deemed

(2) Subsection (1) applies to dispositions that occur after February 27, 1995.

18. (1) Paragraphs 44(1)(*c*) and (*d*) of the Act are replaced by the following:

(*c*) if the former property is described in paragraph (*a*), before the later of the end of the second taxation year following the initial year and 24 months after the end of the initial year, and

(*d*) in any other case, before the later of the end of the first taxation year following the initial year and 12 months after the end of the initial year,

(2) Subsection 44(7) of the Act is amended by striking out the word "or" at the end of paragraph (*a*), by adding the word "or" at the end of paragraph (*b*), and by adding the following after paragraph (*b*):

(*c*) the former property of the taxpayer was disposed of to a partnership in which the taxpayer was, immediately after the disposition, a majority interest partner.

(3) Paragraph 44(1)(*c*) of the Act, as enacted by subsection (1), applies in respect of dispositions that occur in taxation years that end ON OR AFTER THE DAY THAT IS 24 MONTHS BEFORE ANNOUNCEMENT DATE.

(4) Paragraph 44(1)(*d*) of the Act, as enacted by subsection (1), applies in respect of dispositions that occur in taxation years that end ON OR AFTER THE DAY THAT IS 12 MONTHS BEFORE ANNOUNCEMENT DATE.

(5) Subsection (2) applies to dispositions that occur after ANNOUNCEMENT DATE.

19. (1) Paragraph 44.1(6)(*a*) of the Act is replaced by the following:

(*a*) section 51, paragraph 85(1)(*h*), subsection 85.1(1), section 86 or subsection 87(4) applied to the individual in respect of the new shares; and

(2) Paragraph 44.1(7)(*a*) of the Act is replaced by the following:

(*a*) section 51, paragraph 85(1)(*h*), subsection 85.1(1), section 86 or subsection 87(4) applied to the individual in respect of the new shares; and

(3) Section 44.1 of the Act is amended by adding the following after subsection (12):

Order of disposition of shares

(13) For the purpose of this section, an individual is deemed to dispose of shares that are identical properties in the order in which the individual acquired them.

(4) Subsections (1) and (2) apply to dispositions that occur after February 27, 2000.

(5) Subsection (3) applies in respect of dispositions that occur after ANNOUNCEMENT DATE. However, if an individual so elects in writing and files the election with the Minister of National Revenue on or before the individual's filing due date for the individual's taxation year in which this Act is assented to, subsection (3) applies, in respect of the individual, to dispositions that occur after February 27, 2000.

20. (1) Subparagraph 53(2)(*c*)(iii) of the Act is replaced by the following:

(iii) any amount deemed by subsection 110.1(4) or 118.1(8) to have been the eligible amount of a gift made, or by subsection 127(4.2) to have been an amount contributed, by the taxpayer by reason of the taxpayer's membership in the partnership at the end of a fiscal period of the partnership ending before that time,

(2) Subsection (1) applies in respect of gifts and contributions made after ANNOUNCEMENT DATE.

21. (1) Paragraph (*c*) of the definition "superficial loss" in section 54 of the Act is replaced by the following:

(*c*) a disposition deemed by paragraph 33.1(11)(*a*), subsection 45(1), section 50 or 70, subsection 104(4), section 128.1, paragraph 132.2(3)(*a*) or (*c*), subsection 138(11.3) or 142.5(2), paragraph 142.6(1)(*b*) or subsection 144(4.1) or (4.2) or 149(10) to have been made,

(2) Subsection (1) applies to dispositions that occur after 1998.

22. (1) The portion of subsection 54.1(1) of the English version of the Act before paragraph (*a*) is replaced by the following:

Exception to principal residence rules

54.1 (1) A taxation year in which a taxpayer does not ordinarily inhabit the taxpayer's property as a consequence of the relocation of the place of employment of the taxpayer or the taxpayer's spouse or common-law partner while the taxpayer or the taxpayer's spouse or common-law partner, as the case may be, is employed by an employer who is not a person to whom the taxpayer or the taxpayer's spouse or common-law partner is related is deemed not to be a previous taxation year referred to in paragraph (*d*) of the definition "principal residence" in section 54 if

(2) Subsection (1) applies to the 2001 and subsequent taxation years except that, if a taxpayer and a person have jointly elected under section 144 of the *Modernization of Benefits and Obligations Act*, in respect of the 1998, 1999 or 2000 taxation years, subsection (1) applies to the taxpayer and the person in respect of the applicable taxation year and subsequent taxation years.

23. (1) The definition "specified class" in subsection 55(1) of the Act is amended by striking out the word "and" at the end of paragraph (*b*) and by replacing paragraph (*c*) with the following:

(*c*) no holder of the shares is entitled to receive on the redemption, cancellation or acquisition of the shares by the corporation or by any person with whom the corporation does not deal at arm's length an amount (other than a premium for early redemption) that is greater than the total of the fair market value of the consideration for which the shares were issued and the amount of any unpaid dividends on the shares, and

(*d*) the shares are non-voting in respect of the election of the board of directors except in the event of a failure or default under the terms or conditions of the shares;

(2) Subsection 55(1) of the Act is amended by adding the following in alphabetical order:

"qualified person"
« personne admissible »

"qualified person", in relation to a distribution, means a person or partnership with whom the distributing corporation deals at arm's length at all times during the course of the series of transactions or events that includes the distribution if

(*a*) at any time before the distribution,

(i) all of the shares of each class of the capital stock of the distributing corporation that includes shares that cause that person or partnership to be a specified shareholder of the distributing corporation (in this definition all of those shares in all of those classes are referred to as the "exchanged shares") are, in circumstances described in paragraph (*a*) of the definition "permitted exchange", exchanged for consideration that consists solely of shares of a specified class of the capital stock of the distributing corporation (in this definition referred to as the "new shares"), or

(ii) the terms or conditions of all of the exchanged shares are amended (which shares are in this definition referred to after the amendment as the "amended shares") and the amended shares are shares of a specified class of the capital stock of the distributing corporation,

(*b*) immediately before the exchange or amendment, the exchanged shares are listed on a prescribed stock exchange,

(*c*) immediately after the exchange or amendment, the new shares or the amended shares, as the case may be, are listed on a prescribed stock exchange,

(*d*) the exchanged shares would be shares of a specified class if they were not convertible into, or exchangeable for, other shares,

(*e*) the new shares or the amended shares, as the case may be, and the exchanged shares are non-voting in respect of the election of the board of directors of the distributing corporation except in the event of a failure or default under the terms or conditions of the shares, and (*f*) no holder of the new shares or the amended shares, as the case may be, is entitled to receive on the redemption, cancellation or acquisition of the new shares or the amended shares, as the case may be, by the distributing corporation or by any person with whom the distributing corporation does not deal at arm's length an amount (other than a premium for early redemption) that is greater than the total of the fair market value of the consideration for which the exchanged shares were issued and the amount of any unpaid dividends on the new shares or on the amended shares, as the case may be;

(3) Clause 55(3)(*a*)(iii)(B) of the Act is replaced by the following:

(B) property (other than shares of the capital stock of the dividend recipient) more than 10% of the fair market value of which was, at any time during the course of the series, derived from shares of the capital stock of the dividend payer,

(4) Paragraph 55(3.01)(*d*) of the Act is replaced by the following:

(*d*) proceeds of disposition are to be determined without reference to

(i) the expression "paragraph 55(2)(*a*) or" in paragraph (*j*) of the definition "proceeds of disposition" in section 54, and

(ii) section 93; and

(5) Clause 55(3.1)(*b*)(i)(B) of the Act is replaced by the following:

(B) the vendor (other than a qualified person in relation to the distribution) was, at any time during the course of the series, a specified shareholder of the distributing corporation or of the transferee corporation, and

(6) Paragraph 55(3.2)(*h*) of the Act is replaced by the following:

(*h*) in relation to a distribution, each corporation (other than a qualified person in relation to the distribution) that is a shareholder and a specified shareholder of the distributing corporation at any time during the course of a series of transactions or events, a part of which includes the distribution made by the distributing corporation, is deemed to be a transferee corporation in relation to the distributing corporation.

(7) Section 55 of the Act is amended by adding the following after subsection (3.3):

Specified shareholder exclusion

(3.4) In determining whether a person is a specified shareholder of a corporation for the purposes of the definition of "qualified person" in subsection (1), subparagraph (3.1)(*b*)(i) and paragraph (3.2)(*h*) as it applies for the purpose of subparagraph (3.1)(*b*)(iii), the expression "not less than 10% of the issued shares of any class of the capital stock of the corporation" in the definition "specified shareholder" in subsection 248(1) is to be read as "not less than 10% of the issued shares of any class of the capital stock of the corporation, other than shares of a specified class (within the meaning of subsection 55(1))".

Amalgamation of related corporations

(3.5) For the purposes of paragraphs (3.1)(*c*) and (*d*), a corporation formed by an amalgamation of two or more corporations (each of which is referred to in this subsection as a "predecessor corporation") that were related to each other immediately before the amalgamation, is deemed to be the same corporation as, and a continuation of, each of the predecessor corporations.

(8) Section 55 of the Act is amended by adding the following after subsection (5):

Unlisted shares deemed listed

(6) A share (in this subsection referred to as the "reorganization share") is deemed, for the purposes of subsection 116(6) and the definition "taxable Canadian property" in subsection 248(1), to be listed on a prescribed stock exchange if

(*a*) a dividend, to which subsection (2) does not apply because of paragraph (3)(*b*), is received in the course of a reorganization;

(*b*) in contemplation of the reorganization

(i) the reorganization share is issued to a taxpayer by a public corporation in exchange for another share of that corporation (in this subsection referred to as the "old share") owned by the taxpayer, and

(ii) the reorganization share is exchanged by the taxpayer for a share of another public corporation (in this subsection referred to as the "new share") in an exchange that would be a permitted exchange if the definition "permitted exchange" were read without reference to paragraph (*a*) and subparagraph (*b*)(ii) of that definition;

(*c*) immediately before the exchange, the old share

(i) is listed on a prescribed stock exchange, and

(ii) is not taxable Canadian property of the taxpayer; and

(*d*) the new share is listed on a prescribed stock exchange.

(9) Subsection (1) applies in respect of shares issued after ANNOUNCEMENT DATE.

(10) Subsections (2), (5) and (6) and subsection 55(3.4) of the Act, as enacted by subsection (7), apply in respect of dividends received after 1999.

(11) Subsections (3) and (4) apply to dividends received after February 21, 1994.

(12) Subsection 55(3.5) of the Act, as enacted by subsection (7), applies in respect of dividends received after April 26, 1995.

(13) Subsection (8) applies to shares that are issued after April 26, 1995.

24. (1) Section 56 of the Act is amended by adding the following after subsection (11):

Foreign retirement arrangement

(12) If an amount in respect of a foreign retirement arrangement is, as a result of a transaction, an event or a circumstance, considered to be distributed to an individual under the income tax laws of the country in which the arrangement is established, the amount is, for the purpose of paragraph (1)(*a*), deemed to be received by the individual as a payment out of the arrangement in the taxation year that includes the time of the transaction, event or circumstance.

(2) Subsection (1) applies to the 1998 and subsequent taxation years except that, for taxation years that end before 2002, subsection 56(12) of the Act, as enacted by subsection (1), is to be read as follows:

(12) For the purpose of paragraph (1)(*a*),

(*a*) if an amount in respect of a foreign retirement arrangement is considered, under section 408A(d)(3)(C) of the *Internal Revenue Code of 1986* of the United States (in this subsection referred to as the "Code"), to be distributed to an individual as a result of a conversion of the arrangement after 1998 and before 2002, the amount is deemed to be received by the individual as a payment out of the arrangement in the taxation year that includes the time of the conversion; and

(*b*) if an individual received an amount as a payment out of or under a foreign retirement arrangement in 1998, or an amount is considered under section 408A(d)(3)(C) of the Code to be distributed to the individual as a result of a conversion of the arrangement in 1998, the individual was resident in Canada at the time of the receipt or conversion and the amount is an amount to which section 408A(d)(3)(A)(iii) of the Code applies,

(i) the amount is deemed not to have been received by the individual, and

(ii) an amount equal to the amount that is included under section 408A(d)(3)(A)(iii) or 408A(d)(3)(E) of the Code in the individual's gross income for a particular taxable year is deemed to be an amount received by the individual, in the taxation year that includes the day on which the particular taxable year begins, as a payment out of the arrangement, where the expressions "gross income" and "taxable year" in this subparagraph have the meanings assigned to those expressions by the Code.

25. (1) The portion of clause 60(*l*)(ii)(A) of the Act before subclause (I) is replaced by the following:

(A) under which the taxpayer (or, if the taxpayer is physically or mentally infirm, the taxpayer or a trust under which the taxpayer is the sole person beneficially interested in amounts payable under the annuity) is the annuitant

(2) Subsection (1) applies to taxation years that end after 2000.

26. (1) The portion of clause (B) of the description of C in paragraph 63(2)(*b*) of the Act before subclause (I) is replaced by the following:

(B) a person certified in writing by a medical doctor to be a person who

(2) Subsection (1) applies to certifications made after ANNOUNCEMENT DATE.

27. (1) The portion of subsection 66(12.6) of the Act before paragraph (*a*) is replaced by the following:

Canadian exploration expenses to flow-through shareholder

(12.6) If a person gave consideration under an agreement to a corporation for the issue of a flow-through share of the corporation and, in the period that begins on the day the agreement was made and ends 24 months after the end of the month that includes that day, the corporation incurred Canadian exploration expenses (other than an expense deemed by subsection 66.1(9) to be a Canadian exploration expense of the corporation), the corporation may, after it complies with subsection (12.68) in respect of the share and before March of the first calendar year that begins after the period, renounce, effective on the day on which the renunciation is made or on an earlier day set out in the form prescribed for the purpose of subsection (12.7), to the person in respect of the share the amount, if any, by which the portion of those expenses that was incurred on or before the effective date of the renunciation (which portion is in this subsection referred to as the "specified expenses") exceeds the total of

(2) The portion of subsection 66(12.63) of the Act before paragraph (*a*) is replaced by the following:

Effect of renunciation

(12.63) Subject to subsections (12.69) to (12.702), if under subsection (12.62) a corporation renounces an amount to a person,

(3) The portion of subsection 66(12.66) of the French version of the Act before paragraph (*b*) is replaced by the following:

Frais engagés dans l'année suivante

(12.66) Pour l'application des paragraphes (12.6) et (12.601) et de l'alinéa (12.602)*b*), la société qui émet une action accréditive à une personne conformément à une convention est réputée avoir engagé des frais d'exploration au Canada ou des frais d'aménagement au Canada le dernier jour de l'année civile précédant une année civile donnée si les conditions suivantes sont réunies :

a) la société engage les frais au cours de l'année donnée;

a.1) la convention a été conclue au cours de l'année précédente;

(4) Subparagraph 66(12.66)(*b*)(ii) of the Act is replaced by the following:

(ii) would be described in paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6) if the words "paragraphs (*a*) to (*d*) and (*f*) to (*g*.1)" were read as "paragraphs (*a*), (*d*) and (*f*)", or

(5) Subparagraph 66(12.66)(*b*)(iii) of the French version of the Act is replaced by the following:

(iii) seraient des dépenses visées à l'alinéa *f*) de la définition de « frais d'aménagement au Canada » au paragraphe 66.2(5) si le passage « à l'un des alinéas *a*) à *e*) » était remplacé par « aux alinéas *a*) ou *b*) »;

(6) The portion of subsection 66(12.66) of the English version of the Act after paragraph (*e*) is replaced by the following:

the corporation is for the purpose of subsection (12.6), or for the purposes of subsection (12.601) and paragraph (12.602)(*b*), as the case may be, deemed to have incurred the expenses on the last day of that preceding year.

(7) Paragraphs (*d*) and (*e*) of the definition "Canadian resource property" in subsection 66(15) of the Act are replaced by the following:

(*d*) any right to a rental or royalty computed by reference to the amount or value of production from an oil or gas well in Canada, or from a natural accumulation of petroleum or natural gas in Canada, if the payer of the rental or royalty has an interest in the well or accumulation, as the case may be, and 90% or more of the rental or royalty is payable out of, or from the proceeds of, the production from the well or accumulation,

(*e*) any right to a rental or royalty computed by reference to the amount or value of production from a mineral resource in Canada, if the payer of the rental or royalty has an interest in the mineral resource and 90% or more of the rental or royalty is payable out of, or from the proceeds of, the production from the mineral resource,

(8) Paragraph (*g*) of the definition "Canadian resource property" in subsection 66(15) of the Act is replaced by the following:

(*g*) any right to or interest in any property described in any of paragraphs (*a*) to (*f*), other than a right or an interest that the taxpayer has because the taxpayer is a beneficiary under a trust or a member of a partnership;

(9) The definition "flow-through share" in subsection 66(15) of the Act is replaced by the following:

"flow-through share"
« action accréditive »

"flow-through share" means a share (other than a prescribed share) of the capital stock of a principal-business corporation, or a right (other than a prescribed right) to acquire a share of the capital stock of a principal-business corporation, issued to a person under an agreement in writing made between the person and the corporation under which the corporation, for consideration that does not include property to be exchanged or transferred by the person under the agreement in circumstances to which any of sections 51, 85, 85.1, 86 and 87 applies, agrees

(*a*) to incur, in the period that begins on the day that the agreement was made and ends 24 months after the month that includes that day, Canadian exploration expenses or Canadian development expenses in an amount not less than the consideration for which the share or right is to be issued, and

(*b*) to renounce, in prescribed form and before March of the first calendar year that begins after that period, to the person in respect of the share or right, an amount in respect of the Canadian exploration expenses or Canadian development expenses so incurred by it not exceeding the consideration received by the corporation for the share or right;

(10) Subsection 66(17) of the Act is replaced by the following:

Non-arm's length partnerships

(17) For the purpose of paragraph (12.66)(*d*), a partnership and a corporation are, at all times in a calendar year, deemed not to deal with each other at arm's length if

(*a*) an expense is deemed by subsection (12.61) to be incurred by the partnership;

(*b*) the expense would, if this Act were read without reference to paragraph (12.61)(*b*), be incurred in the calendar year by the corporation; and

(*c*) a share of the expense is included, because of paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6), in the Canadian exploration expense of the corporation or of a member of the partnership with whom the corporation, at any time in that calendar year, does not deal at arm's length.

(11) Subsection (1) and (2) apply to renunciations made after ANNOUNCEMENT DATE.

(12) Subsections (3) and (10) apply to expenses incurred after 1996, except that

(*a*) subsection (3) and (10) do not apply to expenses incurred in January or February 1997 in respect of an agreement that was made in 1995;

(*b*) for the purpose of applying paragraph 66(12.66)(*a*.1) of the French version of the Act, as enacted by subsection (3), to expenses incurred in 1998, any agreement made in 1996 is deemed to have been made in 1997.

(13) Subsection (4) applies after December 5, 1996.

(14) Subsection (7) applies to rights acquired after ANNOUNCEMENT DATE.

(15) Subsection (8) applies to rights and interests acquired after ANNOUNCEMENT DATE.

(16) Subsection (9) applies agreements made after ANNOUNCEMENT DATE.

28. (1) Paragraph (*e*) of the definition of "Canadian development expense" in subsection 66.2(5) of the Act is replaced by the following:

(*e*) notwithstanding paragraph 18(l)(*m*), the cost to the taxpayer of any property described in paragraph (*b*), (*e*) or (*f*) of the definition "Canadian resource property" in subsection 66(15) or a right to or interest in such property (other than such a right or interest that the taxpayer has by reason of being a beneficiary under a trust or a member of a partnership) but not including any payment made to any of the persons referred to in any of clauses 18(l)(*m*)(i)(A) to (C) for the preservation of a taxpayer's rights in respect of a

Canadian resource property nor a payment to which paragraph 18(1)(*m*) applied because of clause 18(1)(*m*)(ii)(B),

(2) The portion of the description of F before paragraph (*a*) in the definition of "cumulative Canadian development expense" in subsection 66.2(5) of the Act is replaced by the following:

F is the total of all amounts each of which is an amount in respect of property described in paragraph (*b*), (*e*) or (*f*) of the definition "Canadian resource property" in subsection 66(15) or a right to or interest in such a property, other than such a right or interest that the taxpayer has by reason of being a beneficiary under a trust or a member of a partnership, (in this description referred to as "the particular property") disposed of by the taxpayer before that time equal to the amount, if any, by which

(3) Subsections (1) and (2) apply after ANNOUNCEMENT DATE.

29. (1) Paragraph (*a*) of the definition "Canadian oil and gas property expense" in subsection 66.4(5) of the Act is replaced by the following:

(*a*) notwithstanding paragraph 18(1)(*m*), the cost to the taxpayer of any property described in paragraph (*a*), (*c*) or (*d*) of the definition "Canadian resource property" in subsection 66(15) or a right to or interest in such property (other than such a right or interest that the taxpayer has by reason of being a beneficiary under a trust or a member of a partnership) or an amount paid or payable to Her Majesty in right of the Province of Saskatchewan as a net royalty payment pursuant to a net royalty petroleum and natural gas lease that was in effect on March 31, 1977 to the extent that it can reasonably be regarded as a cost of acquiring the lease, but not including any payment made to any of the persons referred to in any of clauses 18(1)(*m*)(i)(A) to (C) for the preservation of a taxpayer's rights in respect of a Canadian resource property nor a payment (other than a net royalty payment referred to in this paragraph) to which paragraph 18(1)(*m*) applied because of clause 18(1)(*m*)(ii)(B),

(2) The portion of the description of F before paragraph (*a*) in the definition of "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is replaced by the following:

F is the total of all amounts each of which is an amount in respect of property described in paragraph (*a*), (*c*) or (*d*) of the definition "Canadian resource property" in subsection 66(15) or a right to or interest in such a property, other than such a right or interest that the taxpayer has by reason of being a beneficiary under a trust or a member of a partnership, (in this description referred to as "the particular property") disposed of by the taxpayer before that time equal to the amount, if any, by which

(3) Subsections (1) and (2) apply after ANNOUNCEMENT DATE.

30. (1) Section 66.7 of the Act is amended by adding the following after subsection (10):

Amalgamation – partnership property

(10.1) For the purposes of subsections (1) to (5) and the definition "original owner" in subsection 66(15), if at any particular time there has been an amalgamation within the meaning assigned by subsection 87(1), other than an amalgamation to which subsection 87(1.2) applies, of two or more corporations (each of which is referred to in this subsection as a "predecessor corporation") to form one corporate entity (referred to in this subsection as the "new corporation") and immediately before the particular time a predecessor corporation was a member of a partnership that owned a Canadian resource property or a foreign resource property,

(*a*) the predecessor corporation is deemed

(i) to have owned, immediately before the particular time, that portion of each Canadian resource property and of each foreign resource property owned by the partnership at the particular time that is equal to the predecessor corporation's percentage share of the total of the amounts that would be paid to all members of the partnership if the partnership were wound up immediately before the particular time, and

(ii) to have disposed of those portions to the new corporation at the particular time;

(*b*) the new corporation is deemed to have, by way of the amalgamation, acquired those portions at the particular time; and

(*c*) the income of the new corporation for a taxation year that ends after the particular time that can reasonably be attributable to production from those properties is deemed to be the lesser of

(i) the new corporation's share of the part of the income of the partnership for fiscal periods of the partnership that end in the year that can reasonably be regarded as being attributable to production from those properties, and

(ii) the amount that would be determined under subparagraph (i) for the year if the new corporation's share of the income of the partnership for the fiscal periods of the partnership that end in the year were determined on the basis of the percentage share referred to in paragraph (*a*).

(2) Subsection (1) applies to amalgamations that occur after 1996.

31. (1) Paragraph 69(1)(*b*) of the English version of the Act is amended by striking out the word "and" at the end of subparagraph (iii).

(2) Subsection 69(6) of the Act is replaced by the following:

Disposition of petroleum, etc.

(6) An operator with respect to a natural accumulation of petroleum or natural gas in Canada, an oil or gas well in Canada or a mineral resource in Canada who at any time disposes of property, produced in the operation, that is petroleum, natural gas or related hydrocarbons, metal or minerals for no proceeds of disposition or for proceeds of disposition less than its fair market value at that time, is deemed to have received proceeds of disposition for the property equal to that fair market value if the disposition is to

(*a*) Her Majesty in right of Canada or of a province;

(*b*) an agent of Her Majesty in right of Canada or of a province; or

(*c*) a corporation, a commission, or an association that is controlled by Her Majesty in right of Canada or of a province or by an agent of Her Majesty in right of Canada or of a province.

(3) Subsection (1) applies to dispositions that occur after December 23, 1998.

(4) Subsection (2) applies to dispositions that occur after ANNOUNCEMENT DATE.

32. (1) Paragraph 73(3)(*c*) of the Act is replaced by the following:

(*c*) subsection 69(1) does not apply in determining the proceeds of disposition of the depreciable property, the land or the eligible capital property;

(2) Paragraph 73(4)(*b*) of the Act is replaced by the following:

(*b*) subsection 69(1) does not apply in determining the proceeds of disposition of the property; and

(3) Subsections (1) and (2) apply to dispositions that occur after ANNOUNCEMENT DATE.

33. (1) The portion of paragraph 85(1)(*d*.1) of the Act before the description of A is replaced by the following:

(*d*.1) for the purpose of determining after the time of the disposition the amount to be included under paragraph 14(1)(*b*) in computing the corporation's income, there shall be added to the amount otherwise determined for C in the formula in that paragraph the amount determined by the formula

$$1/2 \text{ x } [(A \text{ x } B/C) - 2(D - E)]$$

where

(2) Subsection 85(1) of the Act is amended by adding the following after paragraph (*d*.1):

(*d*.11) for the purpose of determining after the time of the disposition (referred to in this paragraph and in paragraph (*d*.12) as the "disposition time") the amount to be included under paragraph 14(1)(*a*) or (*b*) in computing the corporation's income, there shall be added to the amount otherwise determined for each of A and F in the definition "cumulative eligible capital" in subsection 14(5) the amount, if any, determined by the formula

$$A \text{ x } B/C$$

where

A is the amount, if any, that would be determined for F in that definition in respect of the taxpayer's business at the beginning of the taxpayer's following taxation year if the taxpayer's taxation year that includes the particular time had ended immediately after the disposition time,

B is the fair market value immediately before the disposition time of the eligible capital property disposed of to the corporation by the taxpayer, and

C is the fair market value immediately before the disposition time of all eligible capital property of the taxpayer in respect of the business;

(*d*.12) for the purpose of determining after the disposition time the amount to be included under paragraph 14(1)(*a*) or (*b*) in computing the taxpayer's income, there shall be deducted from the amount otherwise determined for each of A and F in the definition "cumulative eligible capital" in subsection 14(5) the amount, if any, determined by the formula in paragraph (*d*.11) in respect of the disposition;

(3) Subsections (1) and (2) apply in respect of dispositions that occur after ANNOUNCEMENT DATE.

34. (1) Subparagraphs 86.1(2)(*c*)(ii) and (iii) of the Act are replaced by the following:

(ii) at the time of the distribution, the shares of the class that includes the original shares are widely held and

(A) are actively traded on a prescribed stock exchange in the United States, or

(B) are required, under the *Securities Exchange Act of 1934* of the United States, as amended from time to time, to be registered with the Securities and Exchange Commission of the United States and are so registered, and

(iii) under the provisions of the *Internal Revenue Code of 1986* of the United States, as amended from time to time, that apply to the distribution, the shareholders of the particular corporation who are resident in the United States are not taxable in respect of the distribution;

(2) Subparagraph 86.1(2)(*e*)(i) of the Act is replaced by the following:

(i) that, at the time of the distribution, the shares of the class that includes the original shares are shares described in subparagraph (*c*)(ii) or (*d*)(ii),

(3) Subparagraph 86.1(2)(*e*)(vi) of the Act is replaced by the following:

(vi) in the case of a distribution that is not prescribed, that the distribution is not taxable under the provisions of the *Internal Revenue Code of 1986* of the United States, as amended from time to time, that apply to the distribution,

(4) Subsections (1) to (3) apply to distributions made after 1999 except that, with respect to a distribution in respect of original

shares described in clause 86.1(2)(*c*)(ii)(B) of the Act, as enacted by subsection (1),

(*a*) information referred to in paragraph 86.1(2)(*e*) of the Act is deemed to be provided to the Minister of National Revenue on a timely basis if it is provided to that Minister before the 90th day after the day on which this Act is assented to; and

(*b*) an election referred to in paragraph 86.1(2)(*f*) of the Act is deemed to be filed on a timely basis if it is filed with the Minister of National Revenue before the 90th day after the day on which this Act is assented to.

35. (1) Subsection 87(2) of the Act is amended by adding the following after paragraph (*g*.4):

Patronage dividends

(*g*.5) for the purpose of section 135, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(2) Paragraph 87(2)(*j*.91) of the Act is replaced by the following:

Part I.3 and Part VI tax

(*j*.91) for the purpose of determining the amount deductible under subsection 181.1(4) or 190.1(3) by the new corporation for any taxation year, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation, except that this paragraph does not affect the determination of the fiscal period of any corporation or the tax payable by any corporation for any taxation year that ends before the amalgamation;

(3) Subsection 87(2) of the Act is amended by adding the following after paragraph (*l*.3):

Subsection 13(4.2) election

(*l*.4) for the purposes of subsection 13(4.3) and paragraph 20(16.1)(*b*), the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(4) Subsection 87(2) of the Act is amended by adding the following after paragraph (*q*):

Employees profit sharing plan

(*r*) an election made under subsection 144(10) by a predecessor corporation is deemed to be an election made by the new corporation;

(5) Paragraph 87(2)(*mm*) of the Act is repealed.

(6) Section 87 of the Act is amended by adding the following after subsection (2.2):

Quebec credit unions

(2.3) For the purpose of applying this section to an amalgamation governed by section 689 of the *Act Respecting Financial Services Cooperatives*, chapter C-67.3 of the Revised Statutes of Quebec, an investment deposit of a credit union is deemed to be a share of a separate class of the capital stock of a predecessor corporation in respect of the amalgamation the adjusted cost base and paid up capital of which to the credit union is equal to the adjusted cost base to the credit union of the investment deposit immediately before the amalgamation if

(*a*) immediately before the amalgamation, the investment deposit is an investment deposit to which section 425 of the *Savings and Credit Unions Act*, chapter C-4.1 of the Revised Statutes of Quebec, applies to the investment fund of that predecessor corporation; and

(*b*) on the amalgamation the credit union disposes of the investment deposit for consideration that consists solely of shares of a class of the capital stock of the new corporation.

(7) Paragraphs 87(4.4)(*c*) and (*d*) of the Act are replaced by the following:

(*c*) for the consideration under the agreement

(i) a share (in this subsection referred to as the "old share") of the predecessor corporation that was a flow-through share (other than a right to acquire a share) was issued to the person before the amalgamation, or

(ii) a right was issued to the person before the amalgamation to acquire a share that would, if it were issued, be a flow-through share, and

(*d*) the new corporation

(i) issues, on the amalgamation and in consideration for the disposition of the old share, a share (in this subsection referred to as a "new share") of any class of its capital stock to the person (or to any person or partnership that subsequently acquired the old share) and the terms and conditions of the new share are the same as, or substantially the same as, the terms and conditions of the old share, or

(ii) is, because of the right referred to in subparagraph (c)(ii), obliged after the amalgamation to issue to the person a share of any class of the new corporation's capital stock that would, if it were issued, be a flow-through share,

(8) Subsection 87(9) of the Act is amended by adding the following after paragraph (a.2):

(*a*.21) for the purpose of paragraph (4.4)(*d*)

(i) each parent share received by a shareholder of a predecessor corporation is deemed to be a share of the capital stock of the new corporation issued to the shareholder by the new corporation on the merger, and

(ii) any obligation of the parent to issue a share of any class of its capital stock to a person in circumstances described in subparagraph (4.4)(*d*)(ii) is deemed to be an obligation of the new corporation to issue a share to the person;

(9) Subsection (1) applies to amalgamations that occur, and to windings-up that begin, after 1997.

(10) Subsections (2) and (3) apply to amalgamations that occur, and to windings-up that begin, after ANNOUNCEMENT DATE.

(11) Subsection (4) applies to amalgamations that occur, and to windings-up that begin, after 1994.

(12) Subsection (5) applies to amalgamations that occur, and to windings-up that begin, after the 90th day after ANNOUNCEMENT DATE.

(13) Subsection (6) applies to amalgamations that occur after June, 2001.

(14) Subsections (7) and (8) apply to amalgamations that occur after 1997.

36. (1) Paragraph 88(1)(*c*.1) of the Act is replaced by the following:

(*c*.1) for the purpose of determining after the winding-up the amount to be included under subsection 14(1) in computing the parent's income in respect of the business carried on by the subsidiary immediately before the winding-up

(i) there shall be added to the amount otherwise determined for each of A and F in the definition "cumulative eligible capital" in subsection 14(5), the amount, if any, determined for F in that definition in respect of that business immediately before the disposition, and

(ii) there shall be added to the amount determined for C in the formula in paragraph 14(1)(*b*), one-half of the amount, if any, determined for Q in the definition "cumulative eligible capital" in subsection 14(5) in respect of that business immediately before the disposition;

(2) Paragraph 88(1)(*c*.3) of the Act is amended by striking out the word "or" at the end of subparagraph (iv) and by adding the following after subparagraph (v):

(vi) a share of the capital stock of the subsidiary or a debt owing by it, if the share or debt, as the case may be, was owned by the parent immediately before the winding-up, or

(vii) a share of the capital stock of a corporation or a debt owing by a corporation, if the fair market value of the share or debt, as the case may be, was not, at any time after the beginning of the winding-up, wholly or partly attributable to property distributed to the parent on the winding-up;

(3) Subparagraph 88(1)(*c*.4)(i) of the Act is replaced by the following:

(i) a share of the capital stock of the parent that was

(A) received as consideration for the acquisition of a share of the capital stock of the subsidiary by the parent or by a corporation that was a specified subsidiary corporation of the parent immediately before the acquisition, or

(B) issued for consideration that consists solely of money,

(4) Paragraph 88(1)(*e*.6) of the Act is replaced by the following:

(*e*.6) if a subsidiary has made a gift in a taxation year (in this section referred to as the "gift year"), for the purposes of computing the amount deductible under section 110.1 by the parent for its taxation years that end after the subsidiary was wound up, the parent is deemed to have made a gift, in each of its taxation years in which a gift year of the subsidiary ended, equal to the amount, if any, by which the total of all amounts, each of which is the amount of a gift or, in the case of a gift made after ANNOUNCEMENT DATE, the eligible amount of the gift, made by the subsidiary in the gift year exceeds the total of all amounts deducted under section 110.1 by the subsidiary in respect of those gifts;

(5) Subsection (1) applies in respect of dispositions that occur after ANNOUNCEMENT DATE.

(6) Subsections (2) and (3) apply to windings-up that begin after 1997.

(7) Subsection (4) applies to windings-up that begin after ANNOUNCEMENT DATE.

37. (1) The portion of paragraph (*f*) of the definition « compte de dividendes en capital » in subsection 89(1) of the French version of the Act before clause (i)(B) is replaced by the following:

f) le total des montants représentant chacun un montant relatif à une distribution qu'une fiducie a effectuée sur ses gains en capital en faveur de la société au cours de la période et dont le montant est égal au moins élevé des montants suivants:

(i) l'excédent éventuel du montant visé à la division (A) sur le montant visé à la division (B):

(A) le montant de la distribution,

(2) The portion of paragraph (*g*) of the definition « compte de dividendes en capital » in subsection 89(1) of the French version of the Act before subparagraph (ii) is replaced by the following:

g) le total des montants représentant chacun un montant relatif à une distribution qu'une fiducie a effectuée en faveur de la société au cours de la période au titre d'un dividende (sauf un dividende imposable) qui a été versé à la fiducie au cours d'une année d'imposition de celle-ci tout au long de laquelle elle a résidé au Canada, sur une action du capital-actions d'une autre société résidant au Canada, et dont le montant est égal au moins élevé des montants suivants:

(i) le montant de la distribution,

(3) Paragraph (*b*) of the definition "taxable Canadian corporation" in subsection 89(1) of the Act is replaced by the following:

(*b*) was not, by reason of a statutory provision other than paragraph 149(1)(*t*), exempt from tax under this Part;

(4) Subsections (1) and (2) apply to elections in respect of capital dividends that become payable after 1997.

(5) Subsection (3) applies in respect of taxation years that end after 1999.

38. (1) Section 93 of the Act is amended by adding the following after subsection (1.3):

Disposition of foreign affiliate shares

(1.4) If a specified vendor, in respect of a particular corporation resident in Canada, disposes of a share of the capital stock of a foreign affiliate of the particular corporation to a specified purchaser,

(*a*) the share is deemed not to be excluded property of the vendor unless any of subsection 88(3) or paragraphs 95(2)(*c*), (*d*) or (*e*) applied to the disposition of the share; and

(*b*) the cost amount of the share to the purchaser is deemed to be equal to the proceeds of disposition of the share to the vendor.

Specified vendors – foreign affiliates

(1.5) A specified vendor referred to in subsection (1.4) is

(*a*) a foreign affiliate of the particular corporation; or

(*b*) a partnership of which a foreign affiliate of the particular corporation is a member.

Specified purchasers – foreign affiliates

(1.6) A specified purchaser referred to in subsection (1.4) is

(*a*) the particular corporation;

(*b*) a corporation resident in Canada with which the particular corporation does not deal at arm's length;

(*c*) a foreign affiliate of either of those corporations; or

(*d*) a partnership any member of which is described in any of paragraphs (*a*) to (*c*).

(2) Subsection (1) applies to dispositions that occur after ANNOUNCEMENT DATE, other than dispositions required to be made under an agreement in writing made by a vendor on or before ANNOUNCEMENT DATE.

39. (1) Paragraphs (*a*) to (*c*) of the definition "excluded property" in subsection 95(1) of the Act are replaced by the following:

(*a*) used or held by the foreign affiliate principally for the purpose of gaining or producing income from an active business carried on by it,

(*b*) shares of the capital stock of another foreign affiliate of the taxpayer where all or substantially all of the fair market value of the property of the other foreign affiliate is attributable to excluded property,

(*c*) property all or substantially all of the income from which is, or would be, if there was income from the property, income from an active business because of paragraph (2)(*a*) if that paragraph were read without reference to subparagraph (2)(*a*)(v), or

(*c*.1) property arising under or as a result of a written agreement that

(i) provides for the purchase, sale or exchange of currency, and

(ii) can reasonably be considered to have been made by the affiliate to reduce its risk, with respect to an amount that was receivable under a written agreement that relates to the sale of excluded property or with respect to an amount that was receivable and was a property described in paragraph (*c*), of fluctuations in the value of the currency in which the amount receivable was denominated,

(2) The description of B in the definition "foreign accrual property income" in subsection 95(1) of the Act is replaced by:

B is the portion of the affiliate's taxable capital gains for the year from the dispositions of property, other than dispositions of excluded property to which none of subsection 88(3) and paragraphs (2)(*c*), (*d*) and (*e*) apply, that can reasonably be considered to have accrued after its 1975 taxation year,

(3) Subparagraph (*a*)(i) of the definition "investment business" in subsection 95(1) of the Act is replaced by the following:

(i) a business carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of each country in which the business is carried on and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, or

(4) The portion of paragraph (*b*) of the definition "investment business" in subsection 95(1) of the Act before subparagraph (i) is replaced by the following:

(*b*) the affiliate or, if the affiliate carries on the business as a qualifying member of a partnership, the partnership employs

(5) Subparagraph (*b*)(ii) of the definition "investment business" in subsection 95(1) of the Act is amended by striking out the word "or" at the end of clause (ii)(A) and by replacing the portion of subparagraph (ii) after that clause with the following:

(B) in the case where the affiliate carries on the business as a member of the partnership, a person who was a qualifying member of the partnership, or

(C) in the case where the affiliate carries on the business (other than as a member of the partnership), a corporation that was a qualifying shareholder of the affiliate

if the corporations or members referred to in clause (A), (B) or (C) receive compensation from the affiliate or the partnership for the services provided to the affiliate or the partnership by those employees the value of which is not less than the cost to those corporations or members of the compensation paid or accruing to the benefit of those employees that performed the services during the time the services were performed by those employees; **(6) The definition "relevant tax factor" in subsection 95(1) of the Act is replaced by the following:**

"relevant tax factor"
« facteur fiscal approprié »

"relevant tax factor", of a person or partnership for a taxation year, means

(*a*) in the case of a corporation (or a partnership all the members of which, other than non-resident persons, are corporations), the quotient obtained by the formula

$$1/(A-B)$$

where

A is the percentage set out in paragraph 123(1)(*a*), and

B is the percentage that is (or, in the case of a partnership, would be if the partnership were a corporation whose taxation year is the partnership's fiscal period) the corporation's general rate reduction percentage (within the meaning assigned by section 123.4) for the year, and

(*b*) in any other case, 2.2;

(7) Subsection 95(1) of the Act is amended by adding the following in alphabetical order:

"taxable Canadian business"
« entreprise canadienne imposable »

"taxable Canadian business", at any time of a foreign affiliate of a taxpayer resident in Canada or of a partnership of which a foreign affiliate of a taxpayer resident in Canada is a member (which foreign affiliate or partnership is referred to in this definition as the "operator"), means a business the income from which, for the operator's taxation year or fiscal period that includes that time, is income in respect of which

(*a*) tax is payable under this Part by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership, and

(*b*) no exemption from tax under this Part may be claimed under a tax treaty by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership;

(8) Paragraph 95(2)(*a*) of the Act is replaced by the following:

(*a*) in computing the income or loss from an active business for a taxation year of a particular foreign affiliate of a taxpayer in respect of which the taxpayer has a qualifying interest throughout the year there shall be included any income or loss of the particular foreign affiliate for that year from sources in a country other than Canada that would otherwise be income or loss from property of the particular foreign affiliate for the year to the extent that

(i) the income or loss

(A) is derived by the particular foreign affiliate from activities that can reasonably be considered to be directly related to active business activities carried on in a country other than Canada by

(I) any other non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year, or

(II) a life insurance corporation that is resident in Canada throughout the year and that is the taxpayer, a person who controls the taxpayer or a person controlled by the taxpayer, and

(B) would be included in computing the amount prescribed to be the earnings or loss from an active business carried on in a country other than Canada of

(I) the non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year, or

(II) a life insurance corporation that is resident in Canada throughout the year and that is the taxpayer, a person who controls the taxpayer or a person controlled by the taxpayer

if it were a foreign affiliate of the taxpayer and the income were earned by it,

(ii) the income or loss is derived from amounts that were paid or payable, directly or indirectly, to the particular foreign affiliate or a partnership of which the particular foreign affiliate was a member

(A) by

(I) a non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year, or

(II) a partnership of which a non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year is a qualifying member throughout each period, in the fiscal period of the partnership that ends in the year, in which that non-resident corporation was a member of the partnership

to the extent that those amounts that were paid or payable are for expenditures that would, if the non-resident corporation or the partnership were a foreign affiliate of the taxpayer, be deductible by it in the year or a subsequent taxation year in computing the amounts prescribed to be its earnings or loss from an active business, other than an active business carried on in Canada,

(B) by

(I) another foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the year, or

(II) a partnership of which another foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the year is a qualifying member throughout each period, in the fiscal period of the partnership that ends in the year, in which that other foreign affiliate was a member of the partnership

to the extent that those amounts that were paid or payable are for expenditures that were or would be, if the partnership were a foreign affiliate of the taxpayer, deductible in the year or a subsequent taxation year by the other foreign affiliate or the partnership in computing the amounts prescribed to be its earnings or loss from an active business, other than an active business carried on in Canada,

(C) by a partnership of which the particular foreign affiliate is a qualifying member throughout each period, in the fiscal period of the partnership that ends in the year, in which the particular foreign affiliate was a member of the partnership, to the extent that those amounts that were paid or payable were for expenditures that would, if the partnership were a foreign affiliate of the taxpayer, be deductible in the year or a subsequent taxation year in computing the amounts prescribed to be its earnings or loss from an active business carried on by it outside Canada,

(D) by another foreign affiliate of the taxpayer (in this clause referred to as the "second affiliate") to which the particular foreign affiliate and the taxpayer are related throughout the year to the extent that the amounts are paid or payable by the second affiliate

(I) under a legal obligation to pay interest on borrowed money used for the purpose of earning income from property, or

(II) on an amount payable for property acquired for the purpose of gaining or producing income from property

where

(III) the property is excluded property of the second affiliate that is shares of a foreign affiliate (other than the particular foreign affiliate) of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the year (in this clause referred to as the "third affiliate"),

(IV) the second affiliate and the third affiliate are resident in the same country for each of their taxation years (each of which taxation years is referred to in subclauses (V) and (VI) as a "relevant taxation year" of the second affiliate or of the third affiliate, as the case may be) that end in the year,

(V) in respect of each of the second affiliate and the third affiliate for each relevant taxation year of that affiliate, either

1. that affiliate is subject to income taxation in that country in that relevant taxation year, or

2. the members or shareholders of that affiliate at the end of that relevant taxation year are subject to income taxation in that country on, in aggregate, all or substantially all of the income of that affiliate for that relevant taxation year in their taxation years in which that relevant taxation year ends or would be so subject to income taxation in that country if that affiliate had income for that relevant taxation year and the income of those members or shareholders for their taxation years in which that relevant taxation year ends consisted only of their share of income of that affiliate for that relevant taxation year, and

(VI) the amounts paid or payable are relevant in computing the income for income tax purposes in that country

1. of the members (each of which members is referred to in this sub-subclause as a "group member") of a group of corporations, if the group is composed of the second affiliate and of one or more other foreign affiliates of the taxpayer (each of which other foreign affiliates is referred to in this sub-subclause as a "group affiliate"), the taxpayer has a qualifying interest in respect of each group affiliate throughout the year, the second affiliate and each group affiliate would (if the reference in subclauses (IV) and (V) to "third affiliate" were read as a reference to "group affiliate") meet the requirements of those subclauses in the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of a group member, from a source, for a taxation year of that group member that ends in the year is attributable to incomes and losses from an active business, or

2. of the second affiliate, if the third affiliate meets the requirements of sub-subclause (V)2 in each relevant taxation year of the third affiliate, the taxpayer has a qualifying interest in respect of the third affiliate throughout the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of the third affiliate, from a source, for a taxation year of the third affiliate that ends in the year is attributable to incomes and losses from an active business, or

(E) by a life insurance corporation that is resident in Canada and that is the taxpayer, a person who controls the taxpayer or a person controlled by the taxpayer, to the extent that those amounts that were paid or payable were for expenditures that are deductible in the year or a subsequent taxation year by the life insurance corporation in computing its income or loss from carrying on its life insurance business outside Canada and are not deductible in the year or a subsequent taxation year in computing its income or loss from carrying on its life insurance business in Canada,

(iii) the income or loss is derived by the particular foreign affiliate from the factoring of trade accounts receivable acquired by the particular foreign affiliate, or a partnership of which the particular foreign affiliate was a member, from a non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year to the extent that the accounts receivable arose in the course of an active business carried on in a country other than Canada by the non-resident corporation,

(iv) the income or loss is derived by the particular foreign affiliate from loans or lending assets acquired by the particular foreign affiliate, or a partnership of which the particular foreign affiliate was a member, from a non-resident corporation to which the particular foreign affiliate and the taxpayer are related throughout the year to the extent that the loans or lending assets arose in the course of an active business carried on in a country other than Canada by the non-resident corporation,

(v) the income or loss is derived by the particular foreign affiliate from the disposition of excluded property that is not capital property, or

(vi) the income or loss is derived by the particular foreign affiliate under or as a result of an agreement that provides for the purchase, sale or exchange of currency and that can reasonably be considered to have been made by the particular foreign affiliate to reduce its risk, with respect to an amount required by this paragraph to be included in computing the particular foreign affiliate's income or loss from an active business, of fluctuations in the value of the currency in which the amount was denominated;

(9) Subparagraph 95(2)(*a*.1)(i) of the Act is replaced by the following:

(i) it is reasonable to conclude that the cost to any person of the property (other than property that is designated property and that was sold to non-resident persons other than the affiliate or sold to the affiliate for sale to non-resident persons) is relevant in computing the income from a business carried on by the taxpayer or by a person resident in Canada with whom the taxpayer does not deal at arm's length or is relevant in computing the income from a business carried on in Canada by a non-resident person with whom the taxpayer does not deal at arm's length, and

(10) The portion of paragraph 95(2)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) if a foreign affiliate of a taxpayer provides services or an undertaking to provide services and

(11) Subparagraph 95(2)(*b*)(i) of the Act is amended by striking out the word "or" at the end of clause (A) and by adding the following after clause (B):

(C) is deductible, or can reasonably be considered to relate to an amount that is deductible, in computing the foreign accrual property income of a controlled foreign affiliate of

(I) any person in relation to whom the affiliate is a controlled foreign affiliate, or

(II) a person related to a person described in subclause (I), or

(12) Paragraph 95(2)(*d*.1) of the Act is replaced by the following:

(*d*.1) if there has been a foreign merger of two or more predecessor foreign corporations, in respect of each of which a taxpayer's surplus entitlement percentage was not less than 90% immediately before the merger, to form a new foreign corporation in respect of which the taxpayer's surplus entitlement percentage immediately after the merger was not less than 90% (other than a foreign merger where, under the income tax law of the country in which the predecessor foreign corporations were resident immediately before the merger, any income, gain or loss was recognized in respect of any property of a predecessor foreign corporation that became property of the new foreign corporation in the course of the merger)

(i) each property of the new foreign corporation that was a property of a predecessor foreign corporation immediately before the merger is deemed to have been disposed of by the predecessor foreign corporation immediately before the merger for proceeds of disposition equal to the cost amount of the property to the predecessor foreign corporation at that time, and

(ii) for the purposes of this subsection and the definition "foreign accrual property income" in subsection (1), the new foreign corporation is, with respect to any disposition by it of any property to which subparagraph (i) applied, deemed to be the same corporation as, and a continuation of, the predecessor foreign corporation that owned the property immediately before the merger,

but for greater certainty nothing in this paragraph affects the determination of whether any property of a predecessor foreign corporation is disposed of on a foreign merger other than a foreign merger to which this paragraph applies;

(13) Paragraph 95(2)(*e*.1) of the Act is replaced by the following:

(*e*.1) if there has been a liquidation and a dissolution of a foreign affiliate (in this paragraph referred to as the "disposing affiliate") of a taxpayer in respect of which, immediately before the liquidation, the taxpayer's surplus entitlement percentage was not less than 90% (other than a liquidation and a dissolution where, under the income tax law of the country in which the disposing affiliate was resident immediately before the liquidation, any income, gain or loss was recognized by the disposing affiliate in respect of any property distributed by it in the course of the liquidation to another foreign affiliate of the taxpayer):

(i) each property of the disposing affiliate that was so distributed to another foreign affiliate of the taxpayer is deemed to have been disposed of by the disposing affiliate for proceeds of disposition equal to the cost amount of the property to the disposing affiliate immediately before the distribution,

(ii) for the purposes of this subsection and the definition "foreign accrual property income" in subsection (1), the other affiliate is, with respect to any disposition by it of property to which subparagraph (i) applied, deemed to be the same corporation as, and a continuation of, the disposing affiliate, and

(iii) the other affiliate's proceeds of disposition of the shares of the capital stock of the disposing affiliate disposed of in the course of the liquidation is deemed to be the adjusted cost base of those shares to the other affiliate immediately before the disposition;

(14) The portion of paragraph 95(2)(*f*) of the Act before subparagraph (i) is replaced by the following:

(*f*) except as otherwise provided in this subsection, each capital gain, capital loss, taxable capital gain and allowable capital loss of a foreign affiliate of the taxpayer from the disposition of property by a person or partnership shall be computed in respect of the taxpayer in accordance with this Part, read without reference to section 26 of the *Income Tax Application Rules*, as though the affiliate were resident in Canada,

(15) The portion of paragraph 95(2)(*f*) of the Act after subparagraph (ii) and before subparagraph (iii) is replaced by the following:

except that in computing any such gain or loss from the disposition of property owned by the person or partnership at the time the affiliate last became a foreign affiliate of the taxpayer there shall not be included such portion of the gain or loss, as the case may be, that can reasonably be considered to have accrued during the period that the affiliate was not a foreign affiliate of

(16) Subsection 95(2) of the Act is amended by adding the following after paragraph (*f*):

(*f*.1) the income or loss from property of a foreign affiliate of a taxpayer shall be computed in respect of the taxpayer in accordance with this Part as though the affiliate were resident in Canada and the income or loss were computed in Canadian currency, except that in computing that income or loss there shall not be included any income or loss that can reasonably be considered to have been realized or to have accrued during any period throughout which the affiliate was not a foreign affiliate of the taxpayer or of a person described in any of subparagraphs (*f*)(iii) to (vii);

(*f*.2) the income or loss of a foreign affiliate of a taxpayer arising from the disposition of excluded property that is not a capital property (other than a disposition of property to which paragraph (*c*), (*d*) or (*e*) or subsection 88(3) applies) shall be computed in respect of the taxpayer in the currency of the country in which the affiliate is resident or in another currency that is reasonable in the circumstances;

(17) Subsection 95(2) of the Act is amended by adding the following after paragraph (*g*.2):

(*g*.3) any income, loss, capital gain or capital loss, derived by a foreign affiliate of a taxpayer under or as a result of an agreement that provides for the purchase, sale or exchange of currency and that can reasonably be considered to have been made by the affiliate to reduce its risk (with respect to property, any particular income, gain or loss determined in reference to which is deemed by paragraph (*g*) to be nil) of fluctuations in the value of currency, is, to the extent of the absolute value of the particular income, gain or loss, deemed to be nil;

(*h*) in applying subsection 39(2) for the purpose of this subdivision, the gains and losses of a foreign affiliate of a taxpayer in respect of excluded property shall be computed in respect of the taxpayer separately from the gains and losses of the affiliate in respect of property that is not excluded property;

(18) Paragraph 95(2)(*i*) of the Act is replaced by the following:

(*i*) any gain or loss determined in accordance with subsection 39(2) of a foreign affiliate of a taxpayer is deemed to be a gain or loss, as the case may be, from the disposition of an excluded property if the gain or loss is

(i) derived from the settlement or extinguishment of a debt all or substantially all of the proceeds from which were used at all times to acquire excluded property or to earn income from an active business or for a combination of those uses, or

(ii) derived under or as a result of an agreement that provides for the purchase, sale or exchange of currency and that can reasonably be considered to have been made by the affiliate to reduce its risk, with respect to a debt referred to in subparagraph (i), of fluctuations in the value of the currency in which the debt was denominated;

(19) Paragraph 95(2)(*k*) of the Act is replaced by the following:

(*j*.1) paragraph (*j*.2) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer and in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member (which foreign affiliate or partnership is referred to in this paragraph and paragraph (*j*.2) as the “operator” and which particular taxation year or particular fiscal period is referred to in this paragraph and paragraph (*j*.2) as the "specified taxation year") if in the specified taxation year

(i) the operator carries on a business (referred to in this paragraph and paragraph (*j*.2) as a "foreign business"),

(ii) the foreign business includes the insuring of risks,

(iii) the foreign business is not, at any time, a taxable Canadian business,

(iv) the foreign business is

(A) an investment business, or

(B) a business whose activities include activities deemed by paragraph (*a*.2) or (*b*) to be a separate business, other than an active business, carried on by the affiliate, and

(v) the operator would, if it were a corporation carrying on the foreign business in Canada, be required by law to report in respect of the foreign business to a regulatory authority that is the Superintendent of Financial Institutions or a similar authority of a province;

(*j*.2) if this paragraph applies in respect of a specified taxation year of an operator, in computing the affiliate's foreign accrual property income in respect of the taxpayer from the foreign business for the specified taxation year and each subsequent taxation year or fiscal period in which the foreign business is carried on by the operator

(i) the operator is deemed to be required by law to report to and to have been subject to the supervision of the regulatory authority referred to in subparagraph (*j*.1)(iii), and

(ii) if the operator is a life insurer and the foreign business is a life insurance business, the life insurance policies issued in the conduct of that business are deemed to be life insurance policies in Canada;

(*k*) paragraph (*k*.1) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer and in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member (which foreign affiliate or partnership is referred to in this paragraph and paragraph (*k*.1) as the "operator" and which particular taxation year or particular fiscal period is referred to in this paragraph and paragraph (*k*.1) as the "specified taxation year") if

(i) in the specified taxation year, the operator carries on a business (referred to in this paragraph and, subject to paragraph (*k*.6), in paragraph (*k*.1), as a "foreign business"),

(ii) the foreign business is not, at any time in the specified taxation year, a taxable Canadian business,

(iii) in the specified taxation year, the foreign business is

(A) an investment business,

(B) a business whose activities include activities deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the affiliate, or

(C) a business the income from which is included by paragraph (*l*) in computing the affiliate's income from property for the specified taxation year, and

(iv) in the preceding taxation year or fiscal period,

(A) the operator carried on the foreign business,

(B) the foreign business was not, at any time in that preceding taxation year, a taxable Canadian business, and

(C) the foreign business was not described in any of clauses (iii)(A), (B) or (C);

(*k*.1) if this paragraph applies in respect of a specified taxation year of an operator, in computing the affiliate's foreign accrual property income in respect of the taxpayer from the foreign business for the specified taxation year and each subsequent taxation year or fiscal period in which the foreign business is carried on by the operator

(i) the operator is deemed

(A) to have begun to carry on the foreign business in Canada at the beginning of the specified taxation year, and

(B) to carry on the foreign business in Canada throughout that part of the specified taxation year, and of each of those subsequent taxation years or fiscal periods, in which the foreign business is carried on by the operator,

(ii) if the operator would be required by law to report in respect of the foreign business to the Superintendent of Financial Institutions or a similar authority of a province if the operator were a corporation carrying on the foreign business in Canada,

(A) the operator is deemed to be required by law to report to and to have been subject to the supervision of such regulating authority, and

(B) if the operator is a life insurer and the foreign business is a life insurance business, the life insurance policies issued in the conduct of that business are deemed to be life insurance policies in Canada, and

(iii) paragraphs 138(11.91)(*c*) to (*e*) apply to the operator for the specified taxation year in respect of the foreign business as if

(A) the operator were the insurer referred to in subsection 138(11.91),

(B) the specified taxation year of the operator were the particular taxation year of the insurer referred to in that subsection,

(C) the foreign business of the operator were the business of the insurer referred to in that subsection, and

(D) the reference in paragraph 138(11.91)(*e*) to "designated insurance property in respect of the business" were read as a reference to "used or held by it in the particular taxation year in the course of carrying on the insurance business";

(*k*.2) paragraph (*k*.3) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer or in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member of the partnership (which foreign affiliate or partnership is referred to in this paragraph and paragraph (*k*.3) as the "operator" and which particular taxation year or particular fiscal period is referred to in this paragraph and paragraph (*k*.3) as the "specified taxation year") if

(i) in the preceding taxation year or fiscal period, the operator carried on a business (which is referred to in this paragraph and, subject to paragraph (*k*.6), in paragraph (*k*.3), as the "foreign business"),

(ii) the foreign business was not, at any time in that preceding taxation year or fiscal period, a taxable Canadian business,

(iii) in that preceding taxation year or fiscal period, the foreign business was

(A) an investment business,

(B) a business whose activities included activities deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the affiliate, or

(C) a business the income from which is included by paragraph (*l*) in computing the affiliate's income from property for that preceding taxation year or fiscal period, and

(iv) either

(A) at any time in the specified taxation year the operator carries on the foreign business, and the foreign business is an active business that is not a taxable Canadian business, or

(B) at no time in the specified taxation year does the operator carry on the foreign business;

(*k*.3) if this paragraph applies in respect of a specified taxation year of an operator, in computing the affiliate's foreign accrual property income in respect of the taxpayer from the foreign business for the preceding taxation year or fiscal period referred to in paragraph (*k*.2),

(i) the operator is deemed to have ceased to carry on the foreign business in Canada at the beginning of the specified taxation year,

(ii) paragraphs 138(11.91)(*c*) to (*e*) apply to the operator for the specified taxation year in respect of the foreign business as if

(A) the operator were the insurer referred to in subsection 138(11.91),

(B) the specified taxation year of the operator were the particular taxation year of the insurer referred to in that subsection,

(C) the foreign business of the operator were the business of the insurer referred to in that subsection, and

(D) the reference in paragraph 138(11.91)(*e*) to "designated insurance property in respect of the business" were read as a reference to "used or held by it in the particular taxation year in the course of carrying on the insurance business";

(*k*.4) if at any time a foreign affiliate of a taxpayer resident in Canada, or a partnership at the end of the fiscal period of which includes that time a foreign affiliate of a taxpayer resident in Canada is a member, (which foreign affiliate or partnership is referred to in this paragraph as the "operator"), carries on a business both outside Canada and in Canada and income from the particular part of that business that is carried on in Canada is subject to tax under this Part, for the purposes of paragraphs (*k*) to (*k*.3)

(i) the particular part of the business is deemed to be, at that time, a separate business,

(ii) the assets used, or held, at that time primarily in the course of carrying on the particular part of the business are deemed to be, at that time, used or held in the course of carrying on the separate business,

(iii) any liability incurred, and any reserve established, at that time in the course of carrying on the particular part of the business are deemed to be, at that time, incurred or established in the course of carrying on the separate business, and

(iv) the transactions conducted at that time in the particular part of the business are deemed, at that time, to be transactions conducted in the separate business;

(*k*.5) paragraph (*k*.6) applies for the purposes of paragraph (*k*.1) or (*k*.3), as the case may be, in respect of a particular business of an operator if

(i) the particular business is the operator's foreign business for the specified taxation year described in paragraph (*k*) or for the preceding taxation year or fiscal period described in subparagraph (*k*.2)(iii), as the case may be,

(ii) the activities of the particular business for that taxation year or fiscal period includes activities (referred to in this paragraph and paragraph (*k*.6) as the "described activities") that are

(A) described in clause (*k*)(iii)(B) or (*k*.2)(iii)(B), and

(B) deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for that taxation year or fiscal period, and

(iii) the described activities were not all the activities of the particular business in that taxation year or fiscal period;

(*k*.6) if this paragraph applies in respect of a particular business of an operator, in applying paragraph (*k*.1) or (*k*.3), as the case may be

(i) that part of the particular business that consists of the described activities that are deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period of the operator referred to in paragraph (*k*.1) or (*k*.3), as the case may be, is deemed to be the operator's foreign business carried on in that taxation year or fiscal period,

(ii) the assets used or held by the operator primarily in the course of carrying on the described activities that are deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph (*k*) or (*k*.2), as the case may be, are deemed to be assets used or held by the operator in the course of carrying on the foreign business in that taxation year or fiscal period,

(iii) the portion of the liabilities incurred and the portion of the reserves established, in the course of carrying on the described activities that are deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph (*k*) or (*k*.2), as the case may be, are deemed to be liabilities incurred and reserves established in the course of carrying on the foreign business in that taxation year or fiscal period, and

(iv) subject to subparagraphs (ii) and (iii), the transactions conducted in the course of carrying on the described activities that are deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph (*k*) or (*k*.2), as the case may be, are, to the extent that those transactions relate to those activities, deemed to be transactions conducted in the course of carrying on the foreign business in that taxation year or fiscal period;

(20) Subparagraph 95(2)(*l*)(iii) of the Act is replaced by the following:

(iii) the business is carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(A) of each country in which the business is carried on and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

(B) of the country in which the business is principally carried on, or

(C) if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, and

(21) Subsection 95(2) of the Act is amended by striking out the word "and" at the end of paragraph (*l*) and by adding the following after paragraph (*m*):

(*n*) a non-resident corporation is deemed to be, at any time, a foreign affiliate of a particular corporation resident in Canada in respect of which the particular corporation has a qualifying interest if, at that time,

(i) the non-resident corporation is a foreign affiliate of another corporation that is resident in Canada and that is related (otherwise than because of a right referred to in paragraph 251(5)(*b*)) to the particular corporation, and

(ii) that other corporation has a qualifying interest in respect of the non-resident corporation;

(*o*) a particular person is a qualifying member of a partnership at any particular time if, at that time, the particular person is a member of the partnership and

(i) throughout the period, in the fiscal period of the partnership that includes the particular time, during which the member was a member of the partnership, the particular person is, on a regular, continuous and substantial basis

(A) actively engaged in those activities, of the principal business of the partnership carried on in that fiscal period by the partnership, that are other than activities connected with the provision of or the acquisition of funds required for the operation of that principal business, or

(B) actively engaged in those activities, of a particular business carried on in that fiscal period by the particular person (otherwise than as a member of a partnership) that is similar to the principal business carried on in that fiscal period by the partnership, that are other than activities connected with the provision of or the acquisition of funds required for the operation of the particular business, or

(ii) throughout the period, in the fiscal period of the partnership that includes the particular time, during which the member was a member of the partnership

(A) the total of the fair market value of all partnership interests in the partnership owned by the particular person was equal to or greater than 1% of the total of the fair market value of all partnership interests in the partnership owned by all members of the partnership, and

(B) the total of the fair market value of all partnership interests in the partnership owned by the particular person or persons (other than trusts) related to the particular person was equal to or greater than 10% of the total of the fair market value of all partnership interests in the partnership owned by all members of the partnership;

(*p*) a particular person is a qualifying shareholder of a corporation at any time if throughout the period, in the taxation year of the corporation that includes that time, during which the particular person was a shareholder of the corporation

(i) the particular person owned 1% or more of the issued and outstanding shares (having full voting rights under all circumstances) in the capital of the corporation,

(ii) the particular person, or the particular person and persons (other than trusts) related to the particular person, owned 10% or more of the issued and outstanding shares (having full voting rights under all circumstances) in the capital of the corporation,

(iii) the total of the fair market value of all the issued and outstanding shares of the corporation owned by the particular person is 1% or more of the total fair market value of all the issued and outstanding shares of the corporation, and

(iv) the total of the fair market value of all the issued and outstanding shares of the corporation owned by the particular person or by persons (other than trusts) related to the particular person is 10% or more of the total fair market value of all the issued and outstanding shares of the corporation; and

(*q*) in applying paragraphs (*o*) and (*p*)

(i) where, at any time, interests in a partnership or shares of a corporation (which interests or shares are referred to in this subparagraph as "equity interests") are property of a partnership or are deemed under this paragraph to be property of the partnership, the equity interests are deemed to be owned at that time by each member of the partnership in a proportion equal to the proportion of the equity interests that

(A) the fair market value at that time of the member's partnership interest in the partnership

is of

(B) the fair market value at that time of all members' partnership interests in the partnership, and

(ii) where, at any time, interests in a partnership or shares of a corporation (which interests or shares are referred to in this subparagraph as "equity interests") are property of a non-discretionary trust (within the meaning assigned by subsection 17(15)) or are deemed under this paragraph to be property of such a non-discretionary trust, the equity interests are deemed to be owned at that time by each beneficiary under that trust in a proportion equal to that proportion of the equity interests that

(A) the fair market value at that time of the beneficiary's beneficial interest in the trust

is of

(B) the fair market value at that time of all beneficiaries' beneficial interests in the trust.

(22) Paragraph 95(2.1)(*c*) of the Act is replaced by:

(*c*) the affiliate entered into the agreements

(i) in the course of carrying on, principally with persons with whom the affiliate deals at arm's length, a business (other than a life insurance business) principally carried on in the country (other than Canada) under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, or

(ii) in the course of a life insurance business carried on by the affiliate principally in a country other than Canada and principally with persons with whom the affiliate deals at arm's length if

(A) that country is the country in which the business is principally carried on or is the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, and

(B) the business activities of the affiliate are regulated in each of the countries described in clause (A); and

(23) The portion of subsection 95(2.2) of the Act before paragraph (*a*) is replaced by the following:

Rule for subsection (2)

(2.2) For the purpose of subsection (2), other than paragraph (2)(*f*)

(24) Paragraph 95(2.2)(*b*) of the Act is replaced by the following:

(*b*) a non-resident corporation that was not related to a taxpayer and a foreign affiliate of the taxpayer throughout a particular taxation year is deemed to be related to the taxpayer and to the foreign affiliate throughout that year if

(i) a person has, in that year, acquired or disposed of shares of the non-resident corporation or any other corporation and, because of that acquisition or disposition, the non-resident corporation became (or would have become, if paragraph 251(5)(*b*) did not apply to rights contained in the agreement under which the person acquired the shares), or ceased to be, a non-resident corporation that was related to the taxpayer and to the foreign affiliate, and

(ii) at the beginning, or at the end, of that year, the non-resident corporation was related to the taxpayer and to the foreign affiliate.

(25) Section 95 of the Act is amended by adding the following after subsection (2.2):

Exception re subsection (2.2)

(2.21) Subsection (2.2) does not apply to any income or loss referred to in paragraph (2)(*a*), of a particular foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the taxation year of that particular affiliate, that relates to a transaction or event

(*a*) that occurred before that particular affiliate became, as determined without reference to subsection (2.2), a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest; or

(*b*) that occurred before a non-resident corporation (other than that particular affiliate), or a foreign affiliate of the taxpayer (other than that particular affiliate), referred to in paragraph 95(2)(*a*) became, as determined without reference to subsection (2.2)

(i) a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest, or

(ii) related to the taxpayer and to that particular affiliate.

Rule for paragraph (2)(*f*)

(2.22) In determining for the purpose of applying paragraph (2)(*f*) whether a particular property was owned by a non-resident corporation when it last became a foreign affiliate of a taxpayer, the corporation is deemed to have become a foreign affiliate of the taxpayer at the beginning of a taxation year of the corporation if

(*a*) the corporation was not a foreign affiliate of the taxpayer at the beginning of the year;

(*b*) the corporation was a foreign affiliate of the taxpayer at the end of the year; and

(*c*) a person has, in the year, acquired or disposed of shares of the corporation or of any other corporation and, because of that acquisition or disposition, the non-resident corporation became a foreign affiliate of the taxpayer.

Exception re subsection (2.22)

(2.23) Subsection (2.22) does not apply in determining whether any taxable capital gain or allowable capital loss realized by a non-resident corporation can reasonably be considered to have accrued while the affiliate was not a foreign affiliate of any person specified in any of subparagraphs (2)(*f*)(iii) to (vii).

(26) Paragraph 95(2.4)(*a*) of the Act is replaced by the following:

(*a*) the income is derived by the affiliate in the course of a business conducted principally with persons with whom the affiliate deals at arm's length carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

(i) of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued and of each country in which the business is carried on,

(ii) of the country in which the business is principally carried on, or

(iii) if the affiliate is related to a corporation, of the country under the laws of which the related corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union, and

(27) Section 95 of the Act is amended by adding the following after subsection (2.4):

Exception re paragraph (2)(*a*.3)

(2.41) Paragraph (2)(*a*.3) does not apply to a foreign affiliate of a taxpayer resident in Canada in respect of the affiliate's income for a taxation year derived, directly or indirectly, from indebtedness of persons resident in Canada or from indebtedness in respect of businesses carried on in Canada (referred to in this subsection as the "Canadian indebtedness") if

(*a*) the taxpayer is, at the end of the affiliate's taxation year

(i) a life insurance corporation resident in Canada, the business activities of which are subject by law to the supervision of the Superintendent of Financial Institutions or a similar authority of a province, or

(ii) a corporation resident in Canada that is a subsidiary controlled corporation of a corporation described in subparagraph (i);

(*b*) the Canadian indebtedness is used or held by the affiliate, throughout the period in the taxation year that that indebtedness was used or held by the affiliate, in the course of carrying on a business (in this subsection referred to as the "foreign life insurance business") that is a life insurance business carried on outside Canada (other than a business deemed by paragraph (2)(*a*.2) to be a separate business other than an active business), the activities of which are regulated

(i) in the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, and

(ii) in the country, if any, in which the business is principally carried on;

(*c*) more than 90% of the gross premium revenue of the affiliate for the taxation year in respect of the foreign life insurance business was derived from the insurance or reinsurance of risks (net of reinsurance ceded) in respect of persons

(i) that were non-resident at the time that the policies in respect of those risks were issued or effected, and

(ii) that were at that time dealing at arm's length with the affiliate, the taxpayer and all persons that were related at that time to the affiliate or the taxpayer; and

(*d*) it is reasonable to conclude that the affiliate used or held the Canadian indebtedness

(i) to fund a liability or reserve of the foreign life insurance business, or

(ii) as capital that can reasonably be considered to have been required for the foreign life insurance business.

(28) Subsection 95(3) of the Act is amended by striking out the word "or" at the end of paragraph (*a*) and by adding the following after paragraph (*b*):

(*c*) the transmission of electronic signals or electricity along a transmission system located outside Canada; or

(*d*) the manufacturing or processing outside Canada, in accordance with the taxpayer's specifications and under a contract between the taxpayer and the affiliate, of tangible property that is owned by the taxpayer if the property resulting from the manufacturing or processing is used or held by the taxpayer in the ordinary course of the taxpayer's business carried on in Canada.

(29) Section 95 of the Act is amended by adding the following after subsection (3):

Definition of "designated property"

(3.1) For the purpose of subparagraph (2)(*a*.1)(i), "designated property" means property the income from the sale of which is included in computing the income of a foreign affiliate of a taxpayer resident in Canada and that is

(*a*) property that was manufactured, produced, grown, extracted or processed in Canada by the taxpayer, or by a person with whom the taxpayer does not deal at arm's length, in the course of carrying on a business in Canada;

(*b*) property that was acquired, in the course of carrying on a business in Canada, by a purchaser from a vendor if

(i) the purchaser is the taxpayer or is a person resident in Canada with whom the taxpayer does not deal at arm's length, and

(ii) the vendor is a person

(A) with whom the taxpayer deals at arm's length,

(B) who is not a foreign affiliate of the taxpayer, and

(C) who is not a foreign affiliate of a person resident in Canada with whom the taxpayer does not deal at arm's length; and

(*c*) property that was acquired by a purchaser from a vendor if

(i) the purchaser is the taxpayer or is a person resident in Canada with whom the taxpayer does not deal at arm's length,

(ii) the vendor is a foreign affiliate of

(A) the taxpayer, or

(B) a person resident in Canada with whom the taxpayer does not deal at arm's length, and

(iii) that property was manufactured, produced, grown, extracted or processed in the country under whose laws the vendor is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued and in which the vendor's business is principally carried on.

(30) Subsections (1) and (2), paragraph 95(2)(*a*) (other than subclauses (ii)(A)(II) and (ii)(B)(II) and clause (ii)(C)), of the Act, as enacted by subsection (8), subsections (9) to (11), (15) to (18) and (29) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after ANNOUNCEMENT DATE.

(31) Subsections (3), (20) and (26) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after 2001.

(32) Subsections (4) and (5), subclauses 95(2)(*a*)(ii)(A)(II) and (B)(II), and clause 95(2)(*a*)(ii)(C), of the Act, as enacted by subsection (8), and subsections (14), (21) and (23) to (25) apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999.

(33) Subsection (6) applies to the 2002 and subsequent taxation years.

(34) Subsections (7) and (19) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after ANNOUNCEMENT DATE.

(35) Subsection (12) applies to foreign mergers that occur after ANNOUNCEMENT DATE.

(36) Subsection (13) applies to liquidations that begin after ANNOUNCEMENT DATE.

(37) Subsections (22) and (27) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after 1999.

(38) Subsection (28) applies to the 2001 and subsequent taxation years of a foreign affiliate of a taxpayer.

(39) If a taxpayer referred to in subsection (30), (32) or (37) so elects in writing and files the election with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act is assented to, paragraphs (*a*), (*c*) and (*c*.1) of the definition "excluded property" in subsection 95(1) of the Act, as enacted by subsection (1), subsections (2), (4) and (5), subclauses 95(2)(*a*)(i)(A)(II) and (B)(II) and 95(2)(*a*)(ii)(A)(II) and (B)(II), clause 95(2)(*a*)(ii)(C), subclauses 95(2)(*a*)(ii)(D)(IV) to (VI), clause 95(2)(*a*)(ii)(E) and

subparagraphs 95(2)(*a*)(v) and (vi), of the Act, as enacted by subsection (8), subsections (9), (15) to (18), (21) to (25), (27) and (29) apply to taxation years, of all foreign affiliates of the taxpayer, that begin after 1994 and, notwithstanding subsections 152(4) to (5) of the Act, any assessment of a taxpayer's tax, interest and penalties payable under the Act for any of those taxation years that begin before [ANNOUNCEMENT DATE + 1] shall be made that is necessary to take the election into account.

(40) If a taxpayer referred to in subsection (34) so elects in writing and files the election with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act is assented to, subsections (7) and (19) apply to taxation years, of all foreign affiliates of the taxpayer, that begin after 1994 and, notwithstanding subsections 152(4) to (5) of the Act, any assessment of a taxpayer's tax, interest and penalties payable under the Act for any of those taxation years that begin before [ANNOUNCEMENT DATE + 1] shall be made that is necessary to take the election into account except that, in applying paragraph (*b*) of the definition "taxable Canadian business" in subsection 95(1) of the Act, as enacted by subsection (7), for the 1997 and preceding taxation years of all foreign affiliates of the taxpayer, that paragraph is to be read in respect of those affiliates as follows:

> (*b*) no exemption from tax under this Part may be claimed, by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership, under a comprehensive agreement or convention for the elimination of double taxation on income, between the Government of Canada and the government of another country, which has the force of law in Canada at that time;

(41) In applying subparagraph 95(2)(*k*)(iv) of the Act, as enacted by subsection 46(5) of *An Act to amend the Income Tax Act, the Income Tax Application Rules and related Acts*, Statutes of Canada, 1995, chapter 21, as amended by subsection 305(1) of the *Income Tax Amendments Act, 1997*, Statutes of Canada, 1998, chapter 19, to taxation years, of foreign affiliates of a taxpayer, that end after 1999 and begin before [ANNOUNCEMENT DATE + 1], that subparagraph shall, unless the taxpayer makes a valid election under subsection (40), be read as follows:

> (iv) if the foreign business of the affiliate is a business in respect of which the affiliate would, if the foreign business were carried on in Canada, be required by law to report to a regulating authority in Canada such as the Superintendent of Financial Institutions or a similar authority of a province,

(A) the affiliate is deemed to be required by law to report to and to be subject to the supervision of such regulating authority, and

(B) if the affiliate is a life insurer and the foreign business of the affiliate is a life insurance business, the life insurance policies issued in the conduct of that business is deemed to be life insurance policies in Canada, and

40. (1) Section 96 of the Act is amended by adding the following after subsection (1):

Income allocation to former member

(1.01) If, at any time in a fiscal period of a partnership, a taxpayer ceases to be a member of the partnership

(*a*) for the purposes of subsection (1) and sections 34.1, 34.2, 101, 103 and 249.1, and notwithstanding paragraph 98.1(1)(*d*), the taxpayer is deemed to be a member of the partnership at the end of the fiscal period; and

(*b*) for the purposes of the application of paragraph (2.1)(*b*) and subparagraphs 53(1)(*e*)(i) and 53(2)(*c*)(i) to the taxpayer, the fiscal period of the partnership is deemed to end

(i) immediately before the time at which the taxpayer is deemed by subsection 70(5) to have disposed of the interest in the partnership, where the taxpayer ceased to be a member of the partnership because of the taxpayer's death, and

(ii) immediately before the taxpayer ceased to be a member of the partnership, in any other case.

(2) Paragraph 96(2.4)(*a*) of the English version of the Act is replaced by the following:

(*a*) by operation of any law governing the partnership arrangement, the liability of the member as a member of the partnership is limited (except by operation of a provision of a statute of Canada or a province that limits the member's liability only for debts, obligations and liabilities of the partnership, or any member of the partnership, arising from negligent acts or omissions, from misconduct or from fault of another member of the partnership or an employee, an agent or a representative of the partnership in the course of the partnership business while the partnership is a limited liability partnership);

(3) The portion of subsection 96(3) of the Act before paragraph (*a*) is replaced by the following:

Agreement or election of partnership members

(3) If a taxpayer who was a member of a partnership at any time in a fiscal period has, for any purpose relevant to the computation of the taxpayer's income from the partnership for the fiscal period, made or executed an agreement, a designation or an election under or in respect of the application of any of subsections 13(4), (4.2) and (16) and 14(1.01) and (6), section 15.2, subsections 20(9) and 21(1) to (4), section 22, subsection 29(1), section 34, clause 37(8)(a)(ii)(B), subsections 44(1) and (6), 50(1) and 80(5), (9), (10) and (11), section 80.04, subsections 86.1(2), 97(2), 139.1(16) and (17) and 249.1(4) and (6) that, but for this subsection, would be a valid agreement, designation or election,

(4) Subsection (1) applies in respect of a taxpayer

(*a*) in the case where the taxpayer ceases to be a member of a partnership because of the taxpayer's death, to the 2003 and subsequent taxation years; and

(*b*) in any other case, to the 1995 and subsequent taxation years.

(5) Subsection (2) applies after June 20, 2001.

(6) Subsection (3) applies after ANNOUNCEMENT DATE. However, subsection 96(3) of the Act, as enacted by subsection (3) but read without reference to the expression ", (4.2)", applies to taxation years that end after February 27, 2000.

(7) If a taxpayer, who is a member of a partnership at the end of a particular fiscal period, of the partnership, that ends in the taxpayer's 2000 taxation year, so elects in writing and files the election with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year in which this Act is assented to,

(*a*) subsection 96(1.7) of the *Income Tax Act* does not apply to the taxpayer's 2000 taxation year;

(*b*) the taxpayer is deemed to have a capital gain, a capital loss or a business investment loss in respect of the partnership for the particular fiscal period equal to the amount of the taxable capital

gain, the allowable capital loss or the allowable business investment loss in respect of the partnership for the particular fiscal period, as the case may be, multiplied by the reciprocal of the fraction in paragraph 38(*a*) of the *Income Tax Act* that applies to the partnership for the particular fiscal period;

(*c*) the amount of a capital gain, a capital loss or a business investment loss determined under paragraph (*b*) is deemed to be a capital gain, a capital loss or a business investment loss, as the case may be, of the taxpayer from a disposition of a capital property on the day that the particular fiscal period ends; and

(*d*) except as provided by this subsection, no amount shall be included in computing the taxpayer's taxable capital gains, allowable capital losses and allowable business investment losses in respect of the taxable capital gains, allowable capital losses and allowable business investment losses of the partnership for the particular fiscal period.

41. (1) Section 100 of the Act is amended by adding the following after subsection (4):

Replacement of partnership capital

(5) A taxpayer who pays an amount at any time in a taxation year is deemed to have a capital loss from a disposition of property for the year if

(*a*) the taxpayer disposed of an interest in a partnership before that time or, because of subsection (3), acquired before that time a right to receive property of a partnership;

(*b*) that time is after the disposition or acquisition, as the case may be;

(*c*) the amount would have been described in subparagraph 53(1)(*e*)(iv) had the taxpayer been a member of the partnership at that time; and

(*d*) the amount is paid pursuant to a legal obligation of the taxpayer to pay the amount.

(2) Subsection (1) applies to the 1995 and subsequent taxation years.

42. (1) The portion of subsection 104(1.1) of the Act before paragraph (*a*) is replaced by the following:

Restricted meaning of “beneficiary”

(1.1) Notwithstanding subsection 248(25), for the purposes of subsection (1), paragraph (4)(*a*.4), subparagraph 73(1.02)(*b*)(ii) and paragraph 107.4(1)(*e*), a person or partnership is deemed not to be a beneficiary under a trust at a particular time if the person or partnership is beneficially interested in the trust at the particular time solely because of

(2) Subsection 104(21.6) of the Act is amended by adding the following after paragraph (*f*):

(*f*.1) if the deemed gains are in respect of capital gains of the trust from dispositions of property after February 27, 2000 and before October 17, 2000 and the taxation year of the taxpayer began after February 27, 2000 and ended after October 17, 2000, the deemed gains are deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of capital property in the taxpayer’s taxation year and in the period that began after February 27, 2000 and ended before October 18, 2000;

(3) Subsection 104(29) of the Act is replaced by the following:

Amounts deemed payable to beneficiaries

(29) For the purposes of this section, an amount designated by a trust in its return of income for a taxation year throughout which it was resident in Canada is deemed to have become, in the proportions that the trust designates in that return of income, payable by the trust to particular beneficiaries under the trust in the year if

(*a*) the designated amount does not exceed the amount determined by the formula

$$(A-B) \times C/D$$

where

A is the total of all amounts each of which is

(i) an amount that is not deductible in computing the trust’s income for the year, but that would be deductible in computing that income if this Act were read without reference to paragraph 18(1)(*l*.1) and (*m*),

(ii) an amount that is required by paragraph 12(1)(*o*) or by subsection 69(6) or (7) to be included in computing that income, or

(iii) an amount that is required to be included in computing that income because of an amount designated under this subsection by another trust,

B is the total of all amounts each of which is

(i) an amount that is deductible (otherwise than because of the membership of the trust in a partnership) under paragraph 20(1)(*v*.1) in computing the trust's income for the year, or

(ii) an amount that is not included in computing that income, but that would be included in computing that income if this Act were read without reference to section 80.2,

C is the total of all amounts each of which is a portion of the trust's income for the year computed without reference to the provisions of this Act (in this subsection referred to as the "trust-purpose income of the trust for the year") that

(i) was payable in the year to a beneficiary under the trust, or

(ii) was required by subsection 105(2) to be included in computing the income of a beneficiary under the trust, and

D is the trust-purpose income of the trust for the year; and

(*b*) the designated proportions are reasonable having regard to the portions of the trust-purpose income of the trust for the year that are included in computing the beneficiaries' incomes for the year.

(4) Subsection (1) applies to the 1998 and subsequent taxation years.

(5) Subsection (2) applies to taxation years that end after February 27, 2000.

(6) Subsection (3) applies to trust taxation years that end after ANNOUNCEMENT DATE.

43. (1) Subparagraph 107(2)(*b*.1)(iii) of the Act is replaced by the following:

(iii) in any other case, 50%;

(2) The portion of paragraph 107(2)(*c*) of the Act before subparagraph (i) is replaced by the following:

(*c*) the taxpayer's proceeds of disposition of the capital interest in the trust (or of the part of it) disposed of by the taxpayer on the distribution are deemed to be equal to the amount, if any, by which

(3) Section 107 of the Act is amended by adding the following after subsection (4.1):

Distribution of property received on qualifying disposition

(4.2) Subsection (2.1) applies (and subsection (2) does not apply) at any time to property distributed after ANNOUNCEMENT DATE to a beneficiary by a personal trust or a trust prescribed for the purpose of subsection (2), if

(*a*) at a particular time before ANNOUNCEMENT DATE + 1 there was a qualifying disposition (within the meaning assigned by subsection 107.4(1)) of the property, or of other property for which the property is substituted, by a particular partnership or a particular corporation, as the case may be, to a trust; and

(*b*) the beneficiary is neither the particular partnership nor the particular corporation.

(4) Subsections (1) and (3) apply to distributions made after ANNOUNCEMENT DATE.

(5) Subsection (2) applies to distributions made after 1999.

44. (1) The portion of subsection 107.4(1) of the Act before paragraph (*a*) is replaced by the following:

Qualifying disposition

107.4 (1) In this section, a "qualifying disposition" of a property means a disposition of the property before ANNOUNCEMENT DATE + 1 by a person or partnership, and a disposition of property after ANNOUNCEMENT DATE by an individual, (which person, partnership or individual is referred to in this subsection as the "contributor") as a result of a transfer of the property to a particular trust where

(2) Paragraph 107.4(1)(*d*) of the Act is repealed.

(3) Subsections (1) and (2) are deemed to have come into force on ANNOUNCEMENT DATE.

45. (1) The portion of the definition "testamentary trust" in subsection 108(1) of the Act before paragraph (*a*) is replaced by the following:

"testamentary trust"
« fiducie
testamentaire »

"testamentary trust", in a taxation year, means a trust that arose on and as a consequence of the death of an individual (including a trust referred to in subsection 248(9.1)), other than

(2) The definition "testamentary trust" in subsection 108(1) of the Act is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) a trust that, at any time after ANNOUNCEMENT DATE and before the end of the taxation year, incurs a debt or any other obligation to pay an amount to, or guaranteed by, a beneficiary or any person or partnership with whom any beneficiary of the trust does not deal at arm's length, other than a debt or other obligation owed to a particular beneficiary of the trust and incurred by the trust in satisfaction of the particular beneficiary's right

(i) to enforce payment of an amount of the trust's income or capital gains payable before that time by the trust to the particular beneficiary, or

(ii) to otherwise receive any part of the capital of the trust;

(3) The portion of the definition "trust" in subsection 108(1) of the Act after paragraph (*e*.1) and before paragraph (*f*) is replaced by the following:

and, in applying subsections 104(4), (5), (5.2), (12), (14) and (15) at any time, does not include

(4) Subsections (1) and (2) apply to trust taxation years that end after ANNOUNCEMENT DATE.

(5) Subsection (3) applies to the 1998 and subsequent taxation years.

46. (1) Paragraph 110(1)(*k*) of the Act is replaced by the following:

Part VI.1 tax

(*k*) 3 times the tax payable under subsection 191.1(1) by the taxpayer for the year.

(2) Subsection 110(1.7) of the Act is replaced by the following:

Reduction in exercise price

(1.7) If the amount payable by a taxpayer to acquire securities under an agreement referred to in subsection 7(1) is reduced at any particular time and the conditions in subsection (1.8) are satisfied in respect of the reduction,

(*a*) the rights (referred to in this subsection and subsection (1.8) as the "old rights") that the taxpayer had under the agreement immediately before the particular time are deemed to have been disposed of by the taxpayer immediately before the particular time;

(*b*) the rights (referred to in this subsection and subsection (1.8) as the "new rights") that the taxpayer has under the agreement at the particular time are deemed to be acquired by the taxpayer at the particular time; and

(*c*) the taxpayer is deemed to receive the new rights as consideration for the disposition of the old rights.

Conditions for subsection (1.7) to apply

(1.8) The following are the conditions in respect of the reduction:

(*a*) that the taxpayer would not be entitled to a deduction under paragraph (1)(*d*) if the taxpayer acquired securities under the agreement immediately after the particular time and this section were read without reference to subsection (1.7); and

(*b*) that the taxpayer would be entitled to a deduction under paragraph (1)(*d*) if the taxpayer

(i) disposed of the old rights immediately before the particular time,

(ii) acquired the new rights at the particular time as consideration for the disposition, and

(iii) acquired securities under the agreement immediately after the particular time.

(3) Subsection (1) applies to the 2003 and subsequent taxation years.

(4) Subsection (2) applies to reductions that occur after 1998.

(5) An election by a taxpayer under subsection 7(10) of the Act to have subsection 7(8) of the Act apply is deemed to have been filed in a timely manner if

(*a*) it is filed on or before the 60th day after this Act is assented to;

(*b*) it is in respect of a security acquired by the taxpayer before this Act is assented to;

(*c*) the taxpayer is entitled to a deduction under paragraph 110(1)(*d*) of the Act in respect of the acquisition; and

(*d*) the taxpayer would not have been so entitled if subsection 110(1.7) of the Act, as enacted by subsection (2), did not apply.

47. (1) The portion of paragraph 110.1(1)(*a*) of the Act before subparagraph (i) is replaced by the following:

Charitable gifts

(*a*) the total of all amounts each of which is the eligible amount of a gift (other than a gift described in paragraph (*b*), (*c*) or (*d*)) made by the corporation in the year or in any of the five preceding taxation years to

(2) The portion of paragraph 110.1(1)(*b*) of the Act before subparagraph (i) is replaced by the following:

Gifts to Her Majesty

(*b*) the total of all amounts each of which is the eligible amount of a gift (other than a gift described in paragraph (*c*) or (*d*)) made by the corporation to Her Majesty in right of Canada or of a province

(3) Paragraphs 110.1(1)(*c*) and (*d*) of the Act are replaced by the following:

Gifts to institutions

(*c*) the total of all amounts each of which is the eligible amount of a gift (other than a gift described in paragraph (*d*)) of an object that the Canadian Cultural Property Export Review Board has determined meets the criteria set out in paragraphs 29(3)(*b*) and (*c*) of the *Cultural Property Export and Import Act*, which gift was made by the corporation in the year or in any of the five preceding taxation years to an institution or a public authority in Canada that was, at the time the gift was made, designated under subsection 32(2) of that Act either generally or for a specified purpose related to that object; and

Ecological gifts

(*d*) the total of all amounts each of which is the eligible amount of a gift of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude) if

(i) the fair market value of the gift is certified by the Minister of the Environment,

(ii) the land is certified by that Minister, or by a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister or that person, important to the preservation of Canada's environmental heritage, and

(iii) the gift was made by the corporation in the year or in any of the five preceding taxation years to

(A) Her Majesty in right of Canada or of a province,

(B) a municipality in Canada, or

(C) a registered charity one of the main purposes of which is, in the opinion of that Minister, the conservation and protection of Canada's environmental heritage, and that is approved by that Minister or that person in respect of the gift.

(4) The portion of subsection 110.1(2) of the Act before paragraph (*a*) is replaced by the following:

Proof of gift

(2) An eligible amount of a gift shall not be included for the purpose of determining a deduction under subsection (1) unless the making of the gift is evidenced by filing with the Minister

(5) Subsection 110.1(3) of the Act is replaced by the following:

Where subsection (3) applies

(2.1) Subsection (3) applies in circumstances where

(*a*) a corporation makes a gift at any time of

(i) capital property to a donee described in paragraph 110.1(1)(*a*), (*b*) or (*d*), or

(ii) in the case of a corporation not resident in Canada, real property situated in Canada to a prescribed donee who provides an undertaking, in a form satisfactory to the Minister, to the effect that the property will be held for use in the public interest; and

(*b*) the fair market value of the property otherwise determined at that time exceeds its adjusted cost base to the corporation immediately before that time.

Gifts of capital property

(3) If this subsection applies in respect of a gift by a corporation of property, and the corporation designates an amount in respect of the gift in its return of income under section 150 for the year in which the gift is made, the amount so designated is deemed to be its proceeds of disposition of the property and, for the purpose of subsection 248(30), the fair market value of the gift, but the amount so designated may not exceed the fair market value of the property otherwise determined and may not be less than the greater of

(*a*) in the case of a gift made after ANNOUNCEMENT DATE, the amount of the advantage, if any, in respect of the gift, and

(*b*) the amount that is

(i) in the case of depreciable property of a prescribed class, the lesser of the undepreciated capital cost of that class at the end of the taxation year of the corporation that includes that time (determined without reference to proceeds of disposition designated in respect of the property under this subsection), and the adjusted cost base to the corporation of the property immediately before that time, and

(ii) in any other case, the adjusted cost base to the corporation of the property immediately before that time.

(6) Subsection 110.1(4) of the Act is replaced by the following:

Gifts made by partnership

(4) If at the end of a fiscal period of a partnership a corporation is a member of the partnership, its share of any amount that would, if the partnership were a person, be the eligible amount of a gift made by the partnership to any donee is, for the purpose of this section, deemed to be the eligible amount of a gift made to that donee by the corporation in its taxation year in which the fiscal period of the partnership ends.

(7) The portion of paragraph 110.1(5)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) where the gift is a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude, the greater of

(8) Subsections (1) to (4), (6) and (7) apply to gifts made after ANNOUNCEMENT DATE.

(9) Subsection (5) applies to gifts made after 1999 except that, for gifts made after 1999 and on or before ANNOUNCEMENT DATE, the expression "subsection 248(30)" in subsection 110.1(3) of the Act, as enacted by subsection (5), shall be read as "subsection (1)".

48. (1) Subsection 110.6(14) of the Act is amended by adding the following after paragraph (*d*):

(*d*.1) a person who is a member of a partnership that is a member of another partnership is deemed to be a member of the other partnership;

(2) Subsection (1) applies

(*a*) to dispositions that occur after ANNOUNCEMENT DATE; and

(*b*) to dispositions made by a taxpayer after 1999, if the taxpayer so elects in writing and files the election with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year in which this Act is assented to.

49. (1) Subsection 111(1.1) of the Act is amended by striking out the word "and" at the end of paragraph (*a*), by adding the word "and" at the end of paragraph (*b*) and by adding the following after paragraph (*b*):

(*c*) the amount, if any, that the Minister determines to be reasonable in the circumstances, after considering the application of subsections 104(21.6), 130.1(4), 131(1) and 138.1(3.2) to the taxpayer for the particular year.

(2) The description of C in the definition "pre-1986 capital loss balance" in subsection 111(8) of the Act is replaced by the following:

C is the total of all amounts deducted under section 110.6 in computing the individual's taxable income for taxation years that ended before 1988 or begin after October 17, 2000,

(3) Subsections (1) and (2) apply to the 2000 and subsequent taxation years.

50. (1) The portion of subsection 116(5.2) of the Act before paragraph (*a*) is replaced by the following:

Certificates for dispositions

(5.2) If a non-resident person has, in respect of a disposition, or a proposed disposition, in a taxation year to a taxpayer of property (other than excluded property) that is a life insurance policy in Canada, a Canadian resource property, a property (other than capital property) that is real property situated in Canada, a timber resource property, depreciable property that is a taxable Canadian property, eligible capital property that is a taxable Canadian property or any interest in, or option in respect of, a property to which this subsection applies (whether or not that property exists),

(2) Paragraph 116(6)(*f*) of the Act is replaced by the following:

(*f*) property of an authorized foreign bank that carries on a Canadian banking business;

(3) Subsection (1) applies after December 23, 1998.

(4) Subsection (2) applies after June 27, 1999.

51. (1) The portion of the definition "total charitable gifts" in subsection 118.1(1) of the Act before paragraph (*a*) is replaced by the following:

“total charitable gifts”
« total des dons de bienfaisance »

“total charitable gifts”, in respect of an individual for a taxation year, means the total of all amounts each of which is the eligible amount of a gift (other than a gift described in the definition “total Crown gifts”, “total cultural gifts” or “total ecological gifts”) made by the individual in the year or in any of the five preceding taxation years (other than in a year for which a deduction under subsection 110(2) was claimed in computing the individual’s taxable income) to

(2) The portion of the definition “total Crown gifts” in subsection 118.1(1) of the Act before paragraph (*a*) is replaced by the following:

“total Crown gifts”
« total des dons à l’État »

“total Crown gifts”, in respect of an individual for a taxation year, means the total of all amounts each of which is the eligible amount of a gift (other than a gift described in the definition “total cultural gifts” or “total ecological gifts”) made by the individual in the year or in any of the five preceding taxation years to Her Majesty in right of Canada or of a province, to the extent that those amounts were

(3) The portion of the definition “total cultural gifts” in subsection 118.1(1) of the Act before paragraph (*a*) is replaced by the following:

“total cultural gifts”
« total des dons de biens culturels »

“total cultural gifts”, in respect of an individual for a taxation year, means the total of all amounts each of which is the eligible amount of a gift

(4) The definition “total ecological gifts” in subsection 118.1(1) of the Act is replaced by the following:

“total ecological gifts”
« total des dons de biens écosensibles »

“total ecological gifts”, in respect of an individual for a taxation year, means the total of all amounts each of which is the eligible amount of a gift (other than a gift described in the definition “total cultural gifts”) of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude) if

(*a*) the fair market value of the gift is certified by the Minister of the Environment,

(*b*) the land is certified by that Minister, or by a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister or that person, important to the preservation of Canada’s environmental heritage, and

(*c*) the gift was made by the individual in the year or in any of the five preceding taxation years to

(i) Her Majesty in right of Canada or of a province,

(ii) a municipality in Canada, or

(iii) a registered charity one of the main purposes of which is, in the opinion of that Minister, the conservation and protection of Canada’s environmental heritage, and that is approved by that Minister or that person in respect of the gift,

to the extent that those amounts were not included in determining an amount that was deducted under this section in computing the individual’s tax payable under this Part for a preceding taxation year;

(5) The portion of subsection 118.1(2) of the Act before paragraph (*a*) is replaced by the following:

Proof of gift

(2) An eligible amount of a gift shall not be included in the total charitable gifts, total Crown gifts, total cultural gifts or total ecological gifts of an individual unless the making of the gift is evidenced by filing with the Minister

(6) Subsection 118.1(6) of the Act is replaced by the following:

Where subsection (6) applies

(5.4) Subsection (6) applies in circumstances where

(*a*) an individual

(i) makes a gift (by the individual's will or otherwise) at any time of capital property to a donee described in the definition "total charitable gifts", "total Crown gifts" or "total ecological gifts" in subsection (1), or

(ii) who is non-resident, makes a gift (by the individual's will or otherwise) at any time of real property situated in Canada to a prescribed donee who provides an undertaking, in a form satisfactory to the Minister, to the effect that the property will be held for use in the public interest; and

(*b*) the fair market value of the property otherwise determined at that time exceeds its adjusted cost base to the individual immediately before that time.

Gifts of capital property

(6) If this subsection applies in respect of a gift by an individual of property, and the individual or the individual's legal representative designates an amount in respect of the gift in the individual's return of income under section 150 for the year in which the gift is made, the amount so designated is deemed to be the individual's proceeds of disposition of the property and, for the purpose of subsection 248(30), the fair market value of the gift, but the amount so designated may not exceed the fair market value of the property otherwise determined and may not be less than the greater of

(*a*) in the case of a gift made after ANNOUNCEMENT DATE, the amount of the advantage, if any, in respect of the gift, and

(*b*) the amount that is

(i) in the case of depreciable property of a prescribed class, the lesser of the undepreciated capital cost of that class at the end of the taxation year of the individual that includes that time (determined without reference to proceeds of disposition designated in respect of the property under this subsection), and the adjusted cost base to the individual of the property immediately before that time, and

(ii) in any other case, the adjusted cost base to the individual of the property immediately before that time.

(7) Paragraph 118.1(7)(*d*) of the Act is replaced by the following:

(*d*) the amount that the individual or the individual's legal representative designates in the individual's return of income under section 150 for the year in which the gift is made is deemed to be the individual's proceeds of disposition of the work of art and, for the purpose of subsection 248(30), the fair market value of the work of art, but the amount so designated may not exceed the fair market value otherwise determined of the work of art and may not be less than the greater of

(i) the amount of the advantage, if any, in respect of the gift, and,

(ii) the cost amount to the individual of the work of art.

(8) Paragraph 118.1(7.1)(*d*) of the Act is replaced by the following:

(*d*) the individual is deemed to have received at the particular time proceeds of disposition in respect of the work of art equal to the greater of its cost amount to the individual at that time and the amount of the advantage, if any, in respect of the gift.

(9) Subsection 118.1(8) of the Act is replaced by the following:

Gifts made by partnership

(8) If at the end of a fiscal period of a partnership an individual is a member of the partnership, the individual's share of any amount that would, if the partnership were a person, be the eligible amount of a gift made by the partnership to any donee is, for the purpose of this section, deemed to be the eligible amount of a gift made to that donee by the individual in the individual's taxation year in which the fiscal period of the partnership ends.

(10) Paragraphs 118.1(13)(*b*) and (*c*) of the Act are replaced by the following:

(*b*) if the security ceases to be a non-qualifying security of the individual at a subsequent time that is within 60 months after the particular time and the donee has not disposed of the security at or before the subsequent time, the individual is deemed to have made a gift to the donee of property at the subsequent time and the fair market value of that property is deemed to be the lesser of the fair market value of the security at the subsequent time and the fair market value of the security at the particular time that would, if this Act were read without reference to this subsection, have been included in calculating the individual's total charitable gifts or total Crown gifts for a taxation year;

(*c*) if the security is disposed of by the donee within 60 months after the particular time and paragraph (*b*) does not apply to the security, the individual is deemed to have made a gift to the donee of property at the time of the disposition and the fair market value of that property is deemed to be the lesser of the fair market value of any consideration (other than a non-qualifying security of the individual or a property that would be a non-qualifying security of the individual if the individual were alive at that time) received by the donee for the disposition and the fair market value of the security at the particular time that would, if this Act were read without reference to this subsection, have been included in calculating the individual's total charitable gifts or total Crown gifts for a taxation year; and

(11) Subsections (1) to (5) and (7) to (10) apply to gifts made after ANNOUNCEMENT DATE.

(12) Subsection (6) applies to gifts made after 1999 except that, for gifts made after 1999 and on or before ANNOUNCEMENT DATE, the expression "subsection 248(30)" in subsection 118.1(6) of the Act, as enacted by subsection (6), shall be read as "subsection (1)".

52. (1) The description of B in subsection 118.2(1) of the Act is replaced by the following:

B is the total of the individual's medical expenses

(*a*) that are proven by receipts filed with the Minister,

(*b*) that were not included in determining an amount under this subsection or subsection 122.51(2) for a preceding taxation year, and

(*c*) that were paid by the individual or the individual's legal representative within any period of 12 months that ends in the year or, if those expenses were in respect of a person (including the individual) who died in the year, within any period of 24 months that includes the day of the person's death;

(2) Subparagraph 118.2(2)(*c*)(i) of the Act is replaced by the following:

(i) the patient is, and has been certified in writing by a medical practitioner to be, a person who, by reason of mental or physical infirmity, is and is likely to be for a long-continued period of indefinite duration dependent on others for the patient's personal needs and care and who, as a result, requires a full-time attendant,

(3) Paragraphs 118.2(2)(*d*) and (*e*) of the Act are replaced by the following:

(*d*) for the full-time care in a nursing home of the patient, who has been certified in writing by a medical practitioner to be a person who, by reason of lack of normal mental capacity, is and in the foreseeable future will continue to be dependent on others for the patient's personal needs and care;

(*e*) for the care, or the care and training, at a school, institution or other place of the patient, who has been certified in writing by an appropriately qualified person to be a person who, by reason of a physical or mental handicap, requires the equipment, facilities or personnel specially provided by that school, institution or other place for the care, or the care and training, of individuals suffering from the handicap suffered by the patient;

(4) Subparagraph 118.2(2)(*g*)(ii) of the Act is replaced by the following:

(ii) one individual who accompanied the patient, where the patient was, and has been certified in writing by a medical practitioner to be, incapable of travelling without the assistance of an attendant

(5) Paragraph 118.2(2)(*h*) of the Act is replaced by the following:

(*h*) for reasonable travel expenses (other than expenses described in paragraph (*g*)) incurred in respect of the patient and, where the patient was, and has been certified in writing by a medical practitioner to be, incapable of travelling without the assistance of an attendant, in respect of one individual who accompanied the patient, to obtain medical services in a place that is not less than 80 kilometres from the locality where the patient dwells if the circumstances described in subparagraphs (*g*)(iii), (iv) and (v) apply;

(6) Subsection (1) applies to the 2001 and subsequent taxation years.

(7) Subsections (2) to (5) apply to certifications made after ANNOUNCEMENT DATE.

53. (1) Paragraph 118.3(2)(*a*) of the French version of the Act is replaced by the following:

a) d'une part, le particulier demande pour l'année, pour cette personne, une déduction prévue au paragraphe 118(1), soit par application de l'alinéa 118(1)*b*), soit, si la personne est le père, la mère, le grand-père, la grand-mère, un enfant, un petit-enfant, le frère, la soeur, la tante, l'oncle, le neveu ou la nièce du particulier ou de son époux ou conjoint de fait, par application des alinéas 118(1)*c*.1) ou *d*), ou aurait pu demander une telle déduction pour l'année si cette personne n'avait eu aucun revenu pour l'année et avait atteint l'âge de 18 ans avant la fin de l'année et, dans le cas de la déduction prévue à l'alinéa 118(1)*b*), si le particulier n'avait pas été marié ou n'avait pas vécu en union de fait;

(2) Subsection (1) applies to the 2001 and subsequent taxation years.

54. Subparagraph 118.5(1)(*a*)(iii) of the Act is replaced by the following:

(iii) are paid on behalf of, or reimbursed to, the individual by the individual's employer and the amount paid or reimbursed is not included in the individual's income,

55. (1) Subparagraph (*a*)(i) of the definition "designated educational institution" in subsection 118.6(1) of the Act is replaced by the following:

(i) a university, college or other educational institution designated by the Lieutenant Governor in Council of a province as a specified educational institution under the *Canada Student Loans Act*, designated by an appropriate authority under the *Canada Student Financial Assistance Act*, or designated by the Minister of Education of the Province of Quebec for the purposes of the *Act respecting financial assistance for education expenses*, chapter A-13.3 of the Revised Statues of Quebec, or

(2) Subparagraph (*a*)(ii) of the definition "qualifying educational program" in subsection 118.6(1) of the Act is replaced by the following:

(ii) a benefit, if any, received by the student by reason of a loan made to the student in accordance with the requirements of the *Canada Student Loans Act* or the *Act respecting financial assistance for education expenses*, chapter A-13.3 of the Revised Statutes of Quebec, or by reason of financial assistance given to the student in accordance with the requirements of the *Canada Student Financial Assistance Act*, or

(3) Paragraph 118.6(3)(*b*) of the Act is amended by adding the following after subparagraph (i):

(*i*.1) a speech impairment, by a medical doctor or a speech-language pathologist,

(4) Subsections (1) and (2) apply to the 1998 and subsequent taxation years.

(5) Subsection (3) applies to certifications made after October 17, 2000.

56. (1) The description of C in subsection 118.61(1) of the Act is replaced by the following:

C is the lesser of the value of B and the amount that would be the individual's tax payable under this Part for the year if no amount were deductible under this Division (other than an amount deductible under this section and any of sections 118, 118.3 and 118.7);

(2) Paragraph 118.61(2)(*b*) of the Act is replaced by the following:

(*b*) the amount that would be the individual's tax payable under this Part for the year if no amount were deductible under this Division (other than an amount deductible under this section and any of sections 118, 118.3 and 118.7).

(3) Subsections (1) and (2) apply to the 2002 and subsequent taxation years.

57. (1) Paragraph 120.2(3)(*b*) of the Act is replaced by the following:

(*b*) the amount that, if this Act were read without reference to section 120, would be the individual's tax payable under this Part for the year if the individual were not entitled to any deduction under any of sections 126, 127 and 127.4, and

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

58. (1) The portion of paragraph 120.31(3)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) if the eligible taxation year ended before the taxation year preceding the year of receipt, an amount equal to the amount that would be calculated as interest payable on the amount, if any, by which the amount determined under paragraph (*a*) in respect of the eligible taxation year exceeds the taxpayer's tax payable under this Part for that year, if the amount that would be calculated as interest payable on that excess were calculated

(2) Subsection (1) applies to the 1995 and subsequent taxation years.

59. (1) The portion of subparagraph (*b*)(ii) of the definition "split income" in subsection 120.4(1) of the English version of the Act before clause (A) is replaced by the following:

(ii) can reasonably be considered to be income derived from the provision of property or services by a partnership or trust to, or in support of, a business carried on by

(2) The portion of clause (*c*)(ii)(C) of the definition "split income" in subsection 120.4(1) of the English version of the Act before subclause (I) is replaced by the following:

(C) to be income derived from the provision of property or services by a partnership or trust to, or in support of, a business carried on by

(3) Subsections (1) and (2) apply in respect of fiscal periods and taxation years that begin after ANNOUNCEMENT DATE.

60. (1) The portion of subsection 122.3(1) of the Act before paragraph (*a*) is replaced by the following:

Overseas employment tax credit

122.3 (1) If an individual is resident in Canada in a taxation year and, throughout any period of more than six consecutive months that began before the end of the year and included any part of the year (in this section referred to as the "qualifying period")

(2) Subsection 122.3(1.1) of the Act is replaced by the following:

Excluded income

(1.1) No amount may be included under paragraph (1)(*d*) in respect of an individual's income for a taxation year from the individual's employment by an employer

(*a*) if

(i) the employer carries on a business of providing services and does not employ in the business throughout the year more than five full-time employees,

(ii) the individual

(A) does not deal at arm's length with the employer, or is a specified shareholder of the employer, or

(B) where the employer is a partnership, does not deal at arm's length with a member of the partnership, or is a specified shareholder of a member of the partnership, and

(iii) but for the existence of the employer, the individual would reasonably be regarded as being an employee of a person or partnership that is not a specified employer; or

(*b*) if at any time in that portion of the qualifying period that is in the taxation year

(i) the employer provides the services of the individual to a corporation, partnership or trust with which the employer does not deal at arm's length, and

(ii) the fair market value of all the issued shares of the capital stock of the corporation or of all interests in the partnership or trust, as the case may be, that are held by persons who are resident in Canada is less than 10% of the fair market value of all those shares or interests.

(3) Subsections (1) and (2) apply to taxation years that begin after this Act is assented to.

61. (1) Subparagraphs 125(1)(*b*)(i) and (ii) of the Act are replaced by the following:

(i) 4 times the total of the amounts that would be deductible under subsection 126(1) from the tax for the year otherwise payable under this Part by it if those amounts were determined without reference to sections 123.3 and 123.4,

(ii) 3 times the total of the amounts that would be deductible under subsection 126(2) from the tax for the year otherwise payable under this Part by it if those amounts were determined without reference to section 123.4, and

(2) The description of B in the formula in subsection 125(5.1) of the Act is replaced by the following:

B is

(*a*) if, in both the particular taxation year and the preceding taxation year, the corporation is not associated with any corporation, the amount that would, but for subsections 181.1(2) and (4), be the corporation's tax payable under Part I.3 for the preceding taxation year,

(*b*) if the corporation is not associated with any corporation in the particular taxation year but was associated with one or more corporations in the preceding taxation year, the amount that would, but for subsections 181.1(2) and (4), be the corporation's tax payable under Part I.3 for the particular taxation year,

(*c*) if, in the particular taxation year the corporation is associated with one or more particular corporations and in the preceding taxation year the corporation was associated with all of the particular corporations and no other corporation, the total of all amounts each of which would, but for subsections 181.1(2) and (4), be the tax payable under Part I.3 by the corporation, or by any of the particular corporations, for its last taxation year that ended in the preceding calendar year, and

(*d*) if, in the particular taxation year the corporation is associated with one or more particular corporations and in the preceding taxation year the corporation was not associated with all of the particular corporations or was associated with another corporation, the amount determined by the formula

$$0.225\% \text{ of } (D-E)$$

where

D is the total of all amounts each of which is the taxable capital employed in Canada (within the meaning assigned by subsection 181.2(1) or 181.3(1) or section 181.4, as the case may be) of the corporation or of any of the particular corporations for its last taxation year that ended in the preceding calendar year, and

E is $10 million.

(3) Subsection (1) applies to the 2003 and subsequent taxation years.

(4) Subsection (2) applies to taxation years that begin after ANNOUNCEMENT DATE.

62. (1) The definition « bénéfices de fabrication et de transformation au Canada » in subsection 125.1(3) of the French version of the Act is replaced by the following:

"bénéfices de fabrication et de transformation au Canada"
« *Canadian manufacturing and processing profits* »

« bénéfices de fabrication et de transformation au Canada » En ce qui concerne une société pour une année d'imposition, la partie du total des montants représentant chacun le revenu que la société a tiré pour l'année d'une entreprise exploitée activement au Canada, déterminé en vertu des règles établies à cette fin par règlement pris sur recommandation du ministre des Finances, qui doit s'appliquer à la fabrication ou à la transformation au Canada de marchandises destinées à la vente ou à la location.

(2) Subparagraphs (*l*)(i) and (ii) of the definition « fabrication ou transformation » in subsection 125.1(3) of the French version of the Act are replaced by the following:

(i) de la vente ou de la location de marchandises qu'elle a fabriquées ou transformées au Canada,

(ii) de la fabrication ou de la transformation au Canada de marchandises destinées à la vente ou à la location, sauf des marchandises qu'elle devait vendre ou louer elle-même.

63. (1) Paragraph (*a*) of the definition of "Canadian film or video production certificate" in subsection 125.4(1) of the Act is replaced by the following:

(*a*) certifying that the production is a Canadian film or video production in respect of which that Minister is satisfied that

(i) except where the production is a prescribed treaty co-production (as defined by regulation), an acceptable share of revenues from the exploitation of the production in non-

Canadian markets is, under the terms of any agreement, retained by

(A) a qualified corporation that owns or owned an interest in the production,

(B) a prescribed taxable Canadian corporation related to the qualified corporation, or

(C) any combination of corporations described in (A) or (B), and

(ii) public financial support of the production would not be contrary to public policy, and

(2) Section 125.4 of the Act is amended by adding the following after subsection (6):

Guidelines

(7) The Minister of Canadian Heritage shall issue guidelines respecting the circumstances under which the conditions in subparagraphs (*a*)(i) and (ii) of the definition "Canadian film or video production certificate" are satisfied. These guidelines are not statutory instruments as defined in the *Statutory Instruments Act*, but that Minister shall take any feasible steps to bring the guidelines to the notice of persons likely to be affected by them.

(3) Subsections (1) and (2) apply in respect of Canadian film or video productions in respect of which certificates are issued by the Minister of Canadian Heritage after ANNOUNCEMENT DATE.

64. (1) Paragraph 126(4.4)(*a*) of the Act is replaced by the following:

(*a*) a disposition or acquisition of property deemed to be made by subsection 10(12) or (13), 14(14) or (15) or 45(1), section 70, 128.1 or 132.2, subsections 138(11.3) or 142.5(2), paragraph 142.6(1)(*b*), or subsections 142.6(1.1) or (1.2) or subsection 149(10) is not a disposition or acquisition, as the case may be; and

(2) Subsection (1) applies to dispositions and acquisitions that occur after 1998, except that in applying paragraph 126(4.4)(*a*) of the Act, as enacted by subsection (1), to dispositions and acquisitions that occur before June 28, 1999, that paragraph is to be read without its references to subsections 10(12) and (13) and 14(14) and (15).

65. (1) Section 126.1 of the Act is repealed.

(2) Subsection (1) applies in respect of forms filed after the 90th day after ANNOUNCEMENT DATE.

66. (1) The portion of subsection 127(3) of the Act before paragraph (*a*) is replaced by the following:

Contributions to registered parties and candidates

(3) There may be deducted from the tax otherwise payable by a taxpayer under this Part for a taxation year in respect of the total (in this section referred to as "the total") of all amounts each of which is the amount by which a monetary contribution made by the taxpayer in the year to a registered party, or to a candidate whose nomination has been confirmed in an election of a member or members to serve in the House of Commons of Canada, exceeds the amount of the advantage, if any, in respect of the contribution,

(2) Subsection 127(4.2) of the Act is replaced by the following:

Allocation of amount contributed among partners

(4.2) If at the end of a fiscal period of a partnership a taxpayer is a member of the partnership, the taxpayer's share of the total that would, if the partnership were a person and its fiscal period were its taxation year, be the total referred to in subsection (3) in respect of the partnership for that taxation year is deemed for the purpose of that subsection to be a monetary contribution made by the taxpayer in the taxpayer's taxation year in which the fiscal period of the partnership ends.

(3) Paragraphs 127(27)(*b*) and (*c*) of the Act are replaced by the following:

(*b*) the cost, or a portion of the cost, of the particular property was a qualified expenditure, or would if this Act were read without reference to subsection (26) be a qualified expenditure, to the taxpayer,

(*c*) the cost, or the portion of the cost, of the particular property is included, or would if this Act were read without reference to subsection (26) be included, in an amount, a percentage of which can reasonably be considered to be included in computing the taxpayer's investment tax credit at the end of the taxation year, and

(4) The portion of subsection 127(27) of the Act after paragraph (*d*) is replaced by the following:

there shall be added to the taxpayer's tax otherwise payable under this Part for the year the lesser of

(*e*) the amount that can reasonably be considered to be included in the taxpayer's investment tax credit at the end of any taxation year, or that would be so included if this Act were read without reference to subsection (26), in respect of the particular property, and

(*f*) the amount that is the percentage that is the sum of any percentage described in paragraph (*c*) of

(i) in the case where the particular property or the other property is disposed of to a person who deals at arm's length with the taxpayer,

(A) the proceeds of disposition of the property, if the property

(I) is the particular property and is neither first term shared-use equipment nor second term shared-use equipment, or

(II) is the other property,

(B) 25% of the proceeds of disposition of the property, if the property is the particular property, is first term shared-use equipment and is not second term shared-use equipment, and

(C) 50% of the proceeds of disposition of the property, if the property is the particular property and is second term shared-use equipment, and

(ii) in the case where the particular property or the other property is converted to commercial use or is disposed of to a person who does not deal at arm's length with the taxpayer,

(A) the fair market value of the property, if the property

(I) is the particular property and is neither first term shared-use equipment nor second term shared-use equipment, or

(II) is the other property,

(B) 25% of the fair market value of the property at the time of its conversion or disposition, if the particular property is first term shared-use equipment and is not second term shared-use equipment, and

(C) 50% of the fair market of the property at the time of its conversion or disposition, if the particular property is second term shared-use equipment.

(5) Subsections (1) and (2) apply to contributions made after ANNOUNCEMENT DATE.

(6) Subsections (3) and (4) apply to dispositions and conversions that occur after ANNOUNCEMENT DATE.

67. (1) Paragraph (*b*) of the definition "approved share" in subsection 127.4(1) of the Act is replaced by the following:

(*b*) a share issued by a prescribed labour-sponsored venture capital corporation that is not a registered labour-sponsored venture capital corporation if, at the time of the issue, no province under the laws of which the corporation is a labour-sponsored venture capital corporation provides assistance in respect of the acquisition of the share;

(2) Subsection (1) applies to the 2003 and subsequent taxation years.

68. (1) Paragraph 127.52(1)(*d*) of the Act is amended by striking out the word "and" and the end of subparagraph (i), by adding the word "and" at the end of subparagraph (ii) and by adding the following after subparagraph (ii):

(iii) this Act were read without reference to subsection 104(21.6);

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

69. (1) Section 127.531 of the Act is replaced by the following:

Basic minimum tax credit determined

127.531 An individual's basic minimum tax credit for a taxation year is the total of all amounts each of which is (*a*) an amount deducted under subsection 118(1) or (2) or 118.3(1) or any of sections 118.5 to 118.7 in computing the individual's tax payable for the year under this Part, or

(*b*) the amount that was claimed under section 118.1 or 118.2 in computing the individual's tax payable for the year under this Part, determined without reference to this Division, to the extent that the amount claimed does not exceed the maximum amount deductible under that section in computing the individual's tax payable for the year under this Part, determined without reference to this Division.

(2) Subsection (1) applies to the 2002 and subsequent taxation years.

70. (1) Clause (B) of the description of B in the formula in subparagraph 129(3)(*a*)(i) of the French version of the Act is replaced by the following:

(B) 1/30 de son revenu de placement étranger pour cette année,

(2) Subclause (II) of the description of B in the formula in subparagraph 129(3)(*a*)(i) of the English version of the Act is replaced by the following:

(II) 1/30 of its foreign investment income for the year,

(3) Clauses 129(3)(*a*)(ii)(B) and (C) are replaced by the following:

(B) 10/3 of the total of amounts deducted under subsection 126(1) from its tax for the year otherwise payable under this Part, and

(C) 3 times the total of amounts deducted under subsection 126(2) from its tax for the year otherwise payable under this Part, and

(4) Subsections (1) and (2) apply to the 2003 and subsequent taxation years.

71. (1) Paragraph 132.11(1)(*b*) of the Act is replaced by the following:

(*b*) if the trust's taxation year ends on December 15 because of paragraph (*a*), subject to subsection (1.1), each subsequent taxation year of the trust is deemed to be the period that begins at the beginning of December 16 of a calendar year and ends at the end of December 15 of the following calendar year or at such earlier time as is determined under paragraph 132.2(3)(*b*) or subsection 142.6(1); and

(2) Paragraph 132.11(1)(*c*) of the French version of the Act is replaced by the following:

c) chacun de ses exercices qui soit commence dans une de ses années d'imposition se terminant le 15 décembre par l'effet de l'alinéa *a*), soit se termine dans une de ses années d'imposition ultérieures doit prendre fin au plus tard à la fin de l'année où il a commencé.

(3) Subsection (1) applies after 1998, except that in applying paragraph 132.11(1)(*b*) of the Act, as enacted by subsection (1), to taxation years that end before 2000, that paragraph is to be read without reference to the expression "subject to subsection (1.1)".

(4) Subsection (2) applies to the 1998 and subsequent taxation years.

72. (1) Section 132.2 of the Act is replaced by the following:

Definitions re qualifying exchange of mutual funds

132.2 (1) The following definitions apply in this section.

"first post-exchange year"
« première année suivant l'échange »

"first post-exchange year", of a fund in respect of a qualifying exchange, means the taxation year of the fund that begins immediately after the acquisition time.

"qualifying exchange"
« échange admissible »

"qualifying exchange" means a transfer at any time (in this section referred to as the "transfer time") of all or substantially all of the property of a mutual fund corporation or mutual fund trust to a mutual fund trust (in this section referred to as the "transferor" and "transferee", respectively, and as the "funds") if

(*a*) all or substantially all of the shares issued by the transferor and outstanding immediately before the transfer time are within 60 days after the transfer time disposed of to the transferor;

(*b*) no person disposing of shares of the transferor to the transferor within that 60-day period (otherwise than pursuant to the exercise of a statutory right of dissent) receives any consideration for the shares other than units of the transferee; and

(*c*) the funds jointly elect, by filing a prescribed form with the Minister on or before the election's due date.

"share"
« *action* »

"share" means a share of the capital stock of a mutual fund corporation and a unit of a mutual fund trust.

Timing

(2) In respect of a qualifying exchange, a time mentioned in the following list immediately follows the time that precedes it in the list

(*a*) the transfer time;

(*b*) the first intervening time;

(*c*) the acquisition time;

(*d*) the beginning of the funds' first post-exchange years;

(*e*) the depreciables disposition time;

(*f*) the second intervening time; and

(*g*) the depreciables acquisition time.

General

(3) In respect of a qualifying exchange,

(*a*) each property of a fund, other than property disposed of by the transferor to the transferee at the transfer time and depreciable property, is deemed to have been disposed of, and to have been reacquired by the fund, at the first intervening time, for an amount equal to the lesser of

(i) the fair market value of the property at the transfer time, and

(ii) the greater of

(A) its cost amount, and

(B) the amount that the fund designates in respect of the property in a notification to the Minister accompanying the election in respect of the qualifying exchange;

(*b*) subject to paragraph (*l*), the last taxation years of the funds that began before the transfer time are deemed to have ended at the acquisition time, and their first post-exchange years are deemed to have begun immediately after those last taxation years ended;

(*c*) each depreciable property of a fund (other than property to which subsection (5) applies and property to which paragraph (*d*) would, if this Act were read without reference to this paragraph, apply) is deemed to have been disposed of, and to have been reacquired, by the fund at the second intervening time for an amount equal to the lesser of

(i) the fair market value of the property at the depreciables disposition time, and

(ii) the greater of

(A) the lesser of its capital cost and its cost amount to the disposing fund at the depreciables disposition time, and

(B) the amount that the fund designates in respect of the property in a notification to the Minister accompanying the election in respect of the qualifying exchange;

(*d*) if at the second intervening time the undepreciated capital cost to a fund of depreciable property of a prescribed class exceeds the fair market value of all the property of that class, the excess is to be deducted in computing the fund's income for the taxation year that includes the transfer time and is deemed to have been allowed in respect of property of that class under regulations made for the purpose of paragraph 20(1)(*a*);

(*e*) except as provided in paragraph (*m*), the transferor's cost of any particular property received by the transferor from the transferee as consideration for the disposition of the property is deemed to be

(i) nil, if the particular property is a unit of the transferee, and

(ii) the particular property's fair market value at the transfer time, in any other case;

(*f*) the transferor's proceeds of disposition of any units of the transferee that were received by the transferor as consideration for the disposition of the property, and that were disposed of by the transferor within 60 days after the day that includes the transfer time in exchange for shares of the transferor, are deemed to be nil;

(*g*) if, within 60 days after the day that includes the transfer time, a taxpayer disposes of shares of the transferor to the transferor in exchange for units of the transferee

(i) the taxpayer's proceeds of disposition of the shares and the cost to the taxpayer of the units are deemed to be equal to the cost amount to the taxpayer of the shares immediately before the transfer time, and

(ii) where all of the taxpayer's shares of the transferor have been so disposed of, for the purpose of applying section 39.1 in respect of the taxpayer after that disposition, the transferee is deemed to be the same entity as the transferor;

(*h*) where a share to which paragraph (*g*) applies would, if this Act were read without reference to this paragraph, cease to be a qualified investment (within the meaning assigned by subsection 146(1), 146.1(1) or 146.3(1) or section 204) as a consequence of the qualifying exchange, the share is deemed to be a qualified investment until the earlier of the day that is 60 days after the day that includes the transfer time and the time at which it is disposed of in accordance with paragraph (*g*);

(*i*) there shall be added to the amount determined under the description of A in the definition "refundable capital gains tax on hand" in subsection 132(4) in respect of the transferee for its taxation years that begin after the transfer time the amount, if any, by which

(i) the transferor's refundable capital gains tax on hand (within the meaning assigned by subsection 131(6) or 132(4), as the case may be) at the end of its taxation year that includes the transfer time exceeds

(ii) the transferor's capital gains refund (within the meaning assigned by paragraph 131(2)(*a*) or 132(1)(*a*), as the case may be) for that year;

(*j*) no amount in respect of a non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss of a fund for a taxation year that began before the transfer time is deductible in computing the taxable income of either of the funds for a taxation year that begins after the transfer time;

(*k*) where the transferor is a mutual fund trust, for the purposes of subsections 132.1(1) and 132.1(3) to (5), the transferee is deemed after the transfer time to be the same mutual fund trust as, and a continuation of, the transferor;

(*l*) where the transferor is a mutual fund corporation, (and, for greater certainty, without having any affect on the computation of any amount determined under this Part) for the purpose of

(i) subsection 131(4), the transferor is deemed in respect of any share disposed of in accordance with paragraph (*g*) to be a mutual fund corporation at the time of the disposition, and

(ii) Part I.3, the transferor's taxation year that, if this Act were read without reference to this paragraph, would have included the transfer time is deemed to have ended immediately before the transfer time;

(*m*) for the purpose of determining the funds' capital gains redemptions (as defined in subsection 131(6) or 132(4), as the case may be), for their taxation years that include the transfer time,

(i) the total of the cost amounts to the transferor of all its properties at the end of the year is deemed to be the total of all amounts each of which is

(A) the transferor's proceeds of disposition of a property that was transferred to a transferee on the qualifying exchange, or

(B) the cost amount to the transferor at the end of the year of a property that was not transferred on the qualifying exchange, and

(ii) the transferee is deemed not to have acquired any property that was transferred to it on the qualifying exchange; and

(*n*) except as provided in subparagraph (*l*)(i), the transferor is, notwithstanding subsections 131(8) and 132(6), deemed to be neither a mutual fund corporation nor a mutual fund trust for taxation years that begin after the transfer time.

Qualifying exchange – non-depreciable property

(4) If a transferor transfers a property, other than a depreciable property, to a transferee in a qualifying exchange

(*a*) the transferee is deemed to have acquired the property at the acquisition time, and not to have acquired the property at the transfer time;

(*b*) the transferor's proceeds of disposition of the property and the transferee's cost of the property are deemed to be the lesser of

(i) the fair market value of the property at the transfer time, and

(ii) the greatest of

(A) the cost amount to the transferor of the property at the transfer time,

(B) the amount that the funds agree on in respect of the property in their election, and

(C) the fair market value at the transfer time of the consideration (other than units of the transferee) received by the transferor for the disposition of the property.

Depreciable property

(5) If a transferor transfers a depreciable property to a transferee in a qualifying exchange,

(*a*) the transferor is deemed to have disposed of the property at the depreciables disposition time, and not to have disposed of the property at the transfer time;

(*b*) the transferee is deemed to have acquired the property at the depreciables acquisition time, and not to have acquired the property at the transfer time;

(*c*) the transferor's proceeds of disposition of the property and the transferee's cost of the property are deemed to be the lesser of

(i) the fair market value of the property at the transfer time, and

(ii) the greatest of

(A) the lesser of its capital cost and its cost amount to the transferor immediately before the depreciables disposition time,

(B) the amount that the funds agree on in respect of the property in their election, and

(C) the fair market value at the transfer time of the consideration (other than units of the transferee) received by the transferor for the disposition of the property;

(*d*) where the capital cost of the property to the transferor exceeds the transferor's proceeds of disposition of the property under paragraph (*c*), for the purposes of sections 13 and 20 and any regulations made for the purpose of paragraph 20(1)(*a*),

(i) the property's capital cost to the transferee is deemed to be the amount that was its capital cost to the transferor, and

(ii) the excess is deemed to have been allowed to the transferee in respect of the property under regulations made for the purpose of paragraph 20(1)(*a*) in computing income for taxation years ending before the transfer time; and

(*e*) where two or more depreciable properties of a prescribed class are disposed of by the transferor to the transferee in the same qualifying exchange, paragraph (*c*) applies as if each property so disposed of had been separately disposed of in the order designated by the transferor at the time of making the election in respect of the qualifying exchange or, if the transferor does not so designate any such order, in the order designated by the Minister.

Due date

(6) The due date of an election referred to in paragraph (*c*) of the definition "qualifying exchange" in subsection (1) is

(*a*) the day that is 6 months after the day that includes the transfer time; and

(*b*) on joint application by the funds, any later day that the Minister accepts.

Amendment or Revocation of Election

(7) The Minister may, on joint application by the funds on or before the due date of an election referred to in paragraph (*c*) of the definition "qualifying exchange" in subsection (1), grant permission to amend or revoke the election.

(2) The definitions "first post-exchange year" and "share" in subsection 132.2(1), and subsections 132.2(2) to (5), of the Act, as

enacted by subsection (1), apply to qualifying exchanges that occur after 1998.

(3) If subsection (2) applies to a qualifying exchange, the definition "share" in subsection 132.2(2) of the Act is deemed to have been repealed in respect of the qualifying exchange.

(4) The definition "qualifying exchange" in subsection 132.2(1), and subsections 132.2(6) and (7), of the Act, as enacted by subsection (1), apply to qualifying exchanges that occur after June 1994.

(5) If subsection (4) applies to a qualifying exchange, the definition "qualifying exchange" in subsection 132.2(2) of the Act is deemed to be been repealed in respect of the qualifying exchange.

(6) If a valid election referred to in paragraph (*c*) of the definition "qualifying exchange" in subsection 132.2(2) of the Act was made, the election continues to have the effect of having section 132.2 of the Act, as modified from time to time, apply to the transfer.

(7) If a valid election referred to in subsection 159(4) of the *Income Tax Amendments Act, 1997* was made in respect of a qualifying exchange to read subsection 132.2(1) of the *Income Tax Act* without reference to paragraph 132.2(1)(*p*) of that Act, the election is, on the application of subsection (2), deemed to have the effect of reading subsection 132.2(3) of the Act, as enacted by subsection (2), in respect of the qualifying exchange without reference to paragraph 132.2(3)(*i*).

73. (1) Subsection 134.1(2) of the Act is replaced by the following:

Application

(2) For the purposes of applying subsections 133(6) to (9) (other than the definition "non-resident-owned investment corporation" in subsection 133(8)), section 212 and any tax treaty, a corporation described in subsection (1) is deemed to be a non-resident-owned investment corporation in its first non-NRO year in respect of dividends paid in that year on shares of its capital stock to a non-resident person, to a trust for the benefit of non-resident persons or their unborn issue or to a non-resident-owned investment corporation.

(2) Subsection (1) applies to a corporation that ceases to be a non-resident-owned investment corporation because of a transaction or event that occurs, or a circumstance that arises, in a taxation year of the corporation that ends after February 27, 2000.

74. (1) Subsection 136(1) of the Act is replaced by the following:

Cooperative not private corporation

136. (1) Notwithstanding any other provision of this Act, a cooperative corporation that would, but for this section, be a private corporation is deemed not to be a private corporation except for the purposes of sections 15.1, 123.4, 125, 125.1, 127, 127.1, 152 and 157, the definition "mark-to-market property" in subsection 142.2(1) and the definition "small business corporation" in subsection 248(1) as it applies for the purpose of paragraph 39(1)(*c*).

(2) Subsection 136(2) of the Act is amended by striking out the word "and" after paragraph (*b*) and by replacing paragraph (*c*) with the following:

(*c*) at least 90% of its members are individuals, other cooperative corporations, or corporations or partnerships that carry on the business of farming; and

(*d*) at least 90% of its shares, if any, are held by members described in paragraph (*c*) or by trusts governed by registered retirement savings plans, registered retirement income funds or registered education savings plans the annuitants or subscribers under which are members described in that paragraph.

(3) Subsection (1) applies to the 2001 and subsequent taxation years.

(4) Subsection (2) applies to the 1998 and subsequent taxation years.

75. (1) The definition "member" in subsection 137(6) of the Act is replaced by the following:

"member"
« *membre* »

"member", of a credit union, means

(*a*) a person who is recorded as a member on the records of the credit union and is entitled to participate in and use the services of the credit union, and

(*b*) a registered retirement savings plan, a registered retirement income fund or a registered education savings plan, the annuitant or subscriber under which is a person described in paragraph (*a*).

(2) Subsection 137(7) of the Act is replaced by the following:

Credit union not private corporation

(7) Notwithstanding any other provision of this Act, a credit union that would, if this Act were read without reference to this section, be a private corporation is deemed not to be a private corporation except for the purposes of sections 123.1, 123.4, 125, 127, 127.1, 152 and 157 and the definition "small business corporation" in subsection 248(1) as it applies for the purpose of paragraph 39(1)(*c*).

(3) Subsection (1) applies to the 1996 and subsequent taxation years.

(4) Subsection (2) applies to the 2001 and subsequent taxation years.

76. (1) Subsection 137.1(2) of the Act is replaced by the following:

Amounts not included in income

(2) The following amounts are not to be included in computing the income of a deposit insurance corporation for a taxation year:

(*a*) any premium or assessment received, or receivable, by it in the year from a member institution; and

(*b*) any amount received by it in the year from another deposit insurance corporation to the extent that that amount can reasonably be considered to have been paid out of amounts referred to in paragraph (*a*) received by that the other deposit insurance corporation in any taxation year.

(2) Subsection 137.1(4) of the Act is amended by striking out the word "or" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) any amount paid by it to another deposit insurance corporation that is, because of paragraph (2)(*b*), not included in computing the income of that other deposit insurance corporation; or

(3) Subsections (1) and (2) apply to the 1998 and subsequent taxation years.

77. (1) Subsection 138(2) of the Act is replaced by the following:

Insurer's income or loss

(2) For greater certainty, if a life insurer resident in Canada carries on an insurance business in Canada and in a country other than Canada in a taxation year, its income or loss for the year from carrying on an insurance business is the amount that would be its income or loss for the year from the business carried on in Canada if no amount were included

(*a*) in respect of its gross investment revenue for the year from its property (other than property that was designated insurance property for the year) used or held by it in the course of carrying on an insurance business; and

(*b*) in respect of taxable capital gains and allowable capital losses from dispositions of its property (other than designated insurance property for the taxation year in which it disposed of the property) used or held by it in the course of carrying on an insurance business.

(2) Paragraph 138(11.91)(*d*) of the French version of the Act is repealed.

(3) Subsection 138(11.91) of the English version of the Act is amended by adding the word "and" at the end of paragraph (*d*.1), by striking out the word "and" at the end of paragraph (*e*) and by repealing paragraph (*f*).

(4) Subsections (1) to (3) apply to taxation years that end after 1999.

78. (1) Paragraph 142.6(1)(*b*) of the Act is replaced by the following:

(*b*) if the taxpayer becomes a financial institution, the taxpayer is deemed to have disposed, immediately before the end of its particular taxation year that ends immediately before the particular time and for proceeds equal to its fair market value at that time, of each property held by the taxpayer that is

(i) a specified debt obligation (other than a specified debt obligation that is a mark-to-market property to which subparagraph (ii) applies), or

(ii) a mark-to-market property of the taxpayer for the taxpayer's taxation year that includes the particular time but was not a mark-to-market property of the taxpayer for the particular taxation year.

(2) Subsection (1) applies to taxation years that end after 1998.

79. Subsection 142.7(8) of the Act is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) for the purpose of applying subparagraph 212(1)(*b*)(vii) in respect of the debt obligation, the obligation is deemed to have been issued by the entrant bank at the time that the obligation was issued by the Canadian affiliate.

(2) Subsection (1) applies after June 27, 1999.

80. (1) The portion of subsection 143(3.1) of the Act before the description of B is replaced by the following:

Election in respect of gifts

(3.1) For the purposes of section 118.1, where the eligible amount of a gift made in a taxation year by an *inter vivos* trust referred to in subsection (1) in respect of a congregation would, but for this subsection, be included in the total charitable gifts, total Crown gifts, total cultural gifts or total ecological gifts of the trust for the year and the trust so elects in its return of income under this Part for the year,

(*a*) the trust is deemed not to have made the gift; and

(*b*) each participating member of the congregation is deemed to have made, in the year, such a gift the eligible amount of which is the amount determined by the formula

$$A \times B/C$$

where

A is the eligible amount of the gift made by the trust,

(2) Subsection (1) applies to gifts made after ANNOUNCEMENT DATE.

81. (1) Paragraph (*b*) of the definition "earned income" in subsection 146(1) of the Act is replaced by the following:

(*b*) an amount included under paragraph 56(1)(*b*), (*c*.1), (*c*.2), (*g*) or (*o*) in computing the taxpayer's income for a period in the year throughout which the taxpayer was resident in Canada,

(2) Paragraph (*d*) of the definition « revenu gagné » in subsection 146(1) of the French version of the Act is replaced by the following:

d) soit, dans le cas d'un contribuable visé au paragraphe 115(2), le total qui serait calculé en application de l'alinéa 115(2)*e*) à son égard pour l'année compte non tenu du renvoi à l'alinéa 56(1)*n*) au sous-alinéa 115(2)*e*)(ii) ni du sous-alinéa 115(2)*e*)(iv), à l'exception de toute partie de ce total qui est incluse, en application de l'alinea *c*), dans le total calculé selon la présente définition ou qui est exonérée de l'impôt sur le revenu au Canada par l'effet d'une disposition d'un accord ou convention fiscal conclu avec un autre pays et ayant force de loi au Canada,

(3) Subparagraph (*d*)(i) of the definition "earned income" in subsection 146(1) of the English version of the Act is replaced by the following:

(i) that paragraph were read without reference to subparagraph 115(2)(*e*)(iv), and

(4) Paragraph (*f*) of the definition "earned income" in subsection 146(1) of the Act is replaced by the following:

(*f*) an amount deductible under paragraph 60(*b*) or (*c*.1), or deducted under paragraph 60(*c*.2), in computing the taxpayer's income for the year,

(5) Paragraph (*h*) of the definition "earned income" in subsection 146(1) of the Act is replaced by the following:

(*h*) the portion of an amount included under subparagraph (*a*)(ii) or (*c*)(ii) in determining the taxpayer's earned income for the year because of paragraph 14(1)(*b*)

(6) Subparagraph 146(10.1)(*b*)(ii) of the Act is replaced by the following:

(ii) paragraphs 38(*a*) and (*b*) are to read with the fraction set out in each of those paragraphs replaced by the word "all".

(7) Subsections (1) and (4) apply to the 1997 and subsequent taxation years.

(8) Subsections (2) and (3) apply to the 1993 and subsequent taxation years.

(9) Subsection (5) applies to amounts included in computing income for taxation years in respect of business fiscal periods that end after February 27, 2000.

82. (1) The definition "quarter" in subsection 146.01(1) of the Act is repealed.

(2) Subsection 146.01(8) of the Act is repealed.

(3) Subsections (1) and (2) apply in respect of the 2002 and subsequent taxation years.

83. (1) Subsection 146.1(2) of the Act is amended by adding the following after paragraph (*g*.2):

(*g*.3) the plan provides that an individual is permitted to be designated as a beneficiary under the plan, and that a contribution to the plan in respect of an individual who is a beneficiary under the plan is permitted to be made, only if

(i) in the case of a designation, the individual's Social Insurance Number is provided to the promoter before the designation is made and either

(A) the individual is resident in Canada when the designation is made, or

(B) the designation is made in conjunction with a transfer of property into the plan from another registered education savings plan under which the individual was a beneficiary immediately before the transfer, and

(ii) in the case of a contribution, either

(A) the individual's Social Insurance Number is provided to the promoter before the contribution is made and the individual is resident in Canada when the contribution is made, or

(B) the contribution is made by way of transfer from another registered education savings plan under which the individual was a beneficiary immediately before the transfer;

(2) Section 146.1 of the Act is amended by adding the following after subsection (2.2):

Social Insurance Number not required

(2.3) Notwithstanding paragraph (2)(*g*.3), an education savings plan may provide that an individual's Social Insurance Number need not be provided in respect of

(*a*) a contribution to the plan, if the plan was entered into before 1999; and

(*b*) a designation of a non-resident individual as a beneficiary under the plan, if the individual was not assigned a Social Insurance Number before the designation is made.

(3) Subsections (1) and (2) apply after the 90th day after ANNOUNCEMENT DATE.

84. (1) Paragraph (*b*) of the definition "annuitant" in subsection 146.3(1) of the English version of the Act is replaced by the following:

(*b*) after the death of the first individual, a spouse or common-law partner (in this definition referred to as the "survivor") of the first individual to whom the carrier has undertaken to make payments described in the definition "retirement income fund" out of or under the fund after the death of the first individual, if the survivor is alive at that time and the undertaking was made

(i) pursuant to an election that is described in that definition and that was made by the first individual, or

(ii) with the consent of the legal representative of the first individual, and

(2) The portion of paragraph 146.3(2)(*c*) of the English version of the Act before subparagraph (i) is replaced by the following:

(*c*) if the carrier is a person referred to as a depositary in section 146, the fund provides that

(3) Paragraph 146.3(2)(*f*) of the Act is amended by striking out the word "or" at the end of subparagraph (vi), by adding the word "or" at the end of subparagraph (vii) and by adding the following after subparagraph (vii):

(viii) a deferred profit sharing plan in accordance with subsection 147(19);

(4) The portion of subsection 146.3(9) of the Act before paragraph (*a*) is replaced by the following:

Tax payable on income from non-qualified investment

(9) If a trust that is governed by a registered retirement income fund holds, at any time in a taxation year, a property that is not a qualified investment,

(5) Subparagraph 146.3(9)(*b*)(ii) of the Act is replaced by the following:

(ii) paragraphs 38(*a*) and (*b*) are to read with the fraction set out in each of those paragraphs replaced by the word "all".

(6) Subsection (1) applies to the 2001 and subsequent taxation years except that, if a taxpayer and a person have jointly elected under section 144 of the *Modernization of Benefits and Obligations Act*, in respect of the 1998, 1999 or 2000 taxation years, subsection (1) applies to the taxpayer and the person in respect of the applicable taxation year and subsequent taxation years.

(7) Subsection (2) applies after 2001.

(8) Subsection (3) applies after the 90th day after ANNOUNCEMENT DATE.

(9) Subsection (4) applies to the 2003 and subsequent taxation years.

85. (1) Paragraph 147(2)(*e*) of the Act is replaced by the following:

(*e*) the plan includes a provision stipulating that no right of a person under the plan is capable of any surrender or assignment other than

(i) an assignment under a decree, order or judgment of a competent tribunal, or under a written agreement, that relates to a division of property between an individual and the individual's spouse or common-law partner, or former spouse or common-law partner, in settlement of rights that arise out of, or on a breakdown of, their marriage or common-law partnership,

(ii) an assignment by a deceased individual's legal representative on the distribution of the individual's estate, and

(iii) a surrender of benefits to avoid revocation of the plan's registration;

(2) Subsection 147(5.11) of the Act is repealed.

(3) Subparagraph 147(19)(*b*)(ii) of the Act is replaced by the following:

(ii) who is a spouse or common-law partner, or former spouse or common-law partner, of an employee or former employee referred to in subparagraph (i) and who is entitled to the amount

(A) as a consequence of the death of the employee or former employee, or

(B) under a decree, order or judgment of a competent tribunal, or under a written agreement, that relates to a division of property between the employee or former employee and the individual in settlement of rights that arise out of, or on a breakdown of, their marriage or common-law partnership,

(4) The portion of paragraph 147(19)(*d*) of the French version of the Act before subparagraph (i) is replaced by the following:

d) le montant est transféré directement à l'un des régimes ou fonds suivants au profit du particulier :

(5) Paragraph 147(19)(*d*) of the Act is amended by striking out the word "or" at the end of subparagraph (ii), by adding the word "or" at the end of subparagraph (iii) and by adding the following after subparagraph (iii):

(iv) a registered retirement income fund under which the individual is the annuitant (within the meaning assigned by subsection 146.3(1)).

(6) Subsection (1) applies after the 90th day after ANNOUNCEMENT DATE.

(7) Subsection (2) applies to cessations of employment that occur after 2002.

(8) Subsections (3) to (5) apply to transfers that occur after the 90th day after ANNOUNCEMENT DATE.

86. (1) The definition « versement admissible » in subsection 148.1(1) of the French version of the Act is replaced by the following:

“versement admissible”
« relevant contribution »

« versement admissible » Est un versement admissible effectué pour un particulier dans le cadre d’un arrangement donné :

a) le versement effectué dans le cadre de l’arrangement donné en vue du financement de services de funérailles ou de cimetière relatifs au particulier, à l’exception d’un versement effectué au moyen d’un transfert d’un arrangement de services funéraires;

b) la partie d’un versement effectué dans le cadre d’un arrangement de services funéraires (à l’exception d’un tel versement effectué au moyen d’un transfert d’un arrangement de services funéraires) qu’il est raisonnable de considérer comme ayant ultérieurement servi à effectuer un versement dans le cadre de l’arrangement donné au moyen d’un transfert d’un arrangement de services funéraires en vue du financement de services de funérailles ou de cimetière relatifs au particulier.

(2) The description of C in subsection 148.1(3) of the Act is replaced by the following:

C is the amount determined by the formula

$$D - E$$

where

D is the total of all relevant contributions made before the particular time in respect of the individual under the particular arrangement (other than contributions in respect of the individual that were in a cemetery care trust), and

E is the total of all amounts each of which is the amount, if any, by which

(*a*) an amount relating to the balance in respect of the individual under the arrangement that is deemed by subsection (4) to have been distributed before the particular time from the arrangement

exceeds

(*b*) the portion of the amount referred to in paragraph (*a*) that is added, because of this subsection, in computing a taxpayer's income.

(3) Section 148.1 of the Act is amended by adding the following after subsection (3):

Deemed distribution on transfer

(4) If at a particular time an amount relating to the balance in respect of an individual (referred to in this subsection and subsection (5) as the "transferor") under an eligible funeral arrangement (referred to in this subsection and subsection (5) as the "transferor arrangement") is transferred, credited or added to the balance in respect of the same or another individual (referred to in this subsection and subsection (5) as the "recipient") under the same or another eligible funeral arrangement (referred to in this subsection and subsection (5) as the "recipient arrangement"),

(*a*) the amount is deemed to be distributed to the transferor (or, if the transferor is deceased at the particular time, to the recipient) at the particular time from the transferor arrangement and to be paid from the balance in respect of the transferor under the transferor arrangement; and

(*b*) the amount is deemed to be a contribution made (other than by way of a transfer from an eligible funeral arrangement) at the particular time under the recipient arrangement for the purpose of funding funeral or cemetery services with respect to the recipient.

Non-application of subsection (4)

(5) Subsection (4) does not apply if

(*a*) the transferor and the recipient are the same individual;

(*b*) the amount that is transferred, credited or added to the balance in respect of the individual under the recipient arrangement is equal to the balance in respect of the individual under the transferor arrangement immediately before the particular time; and

(*c*) the transferor arrangement is terminated immediately after the transfer.

(4) Subsections (2) and (3) apply to amounts that are transferred, credited or added after ANNOUNCEMENT DATE.

87. (1) Subsection 149(1.3) of the Act is replaced by the following:

Votes or de facto control

(1.3) Paragraphs (1)(*d*) to (*d*.6) do not apply in respect of a person's taxable income for a period in a taxation year if at any time during the period

(*a*) the person is a corporation shares of which are owned by one or more other persons that, in total, give them more than 10% of the votes that could be cast at a meeting of shareholders of the corporation, other than shares that are owned by one or more persons each of which is

(i) Her Majesty in right of Canada or of a province,

(ii) a municipality in Canada, or

(iii) a commission, an association or a corporation, to which any of paragraphs (1)(*d*) to (*d*.6) apply; or

(*b*) the person is, or would be if the person were a corporation, controlled, directly or indirectly in any manner whatever, by a person, or by a group of persons that includes a person, who is not

(i) Her Majesty in right of Canada or of a province,

(ii) a municipality in Canada, or

(iii) a corporation, a commission or an association, to which any of paragraphs (1)(*d*) to (*d*.6) apply.

(2) Subsection (1) applies to taxation years that begin after ANNOUNCEMENT DATE.

88. (1) Paragraphs (*c*) and (*d*) of the definition "charitable organization" in subsection 149.1(1) of the Act are replaced by the following:

(*c*) more than 50% of the directors, trustees, officers or like officials of which deal at arm's length with each other and with

(i) each of the other directors, trustees, officers and like officials of the organization, and

(ii) each person who, and each member of a group of persons who do not deal with each other at arm's length that, has contributed or otherwise paid into the organization more than 50% of the capital of the organization (other than Her Majesty in right of Canada or of a province, a municipality, another registered charity that is not a private foundation, and any club, society or association described in paragraph 149(1)(*l*)), and

(*d*) that is not, and would not be if the organization were a corporation, controlled directly or indirectly in any manner whatever

(i) by a person that has contributed or otherwise paid into the organization more than 50% of the capital of the organization (other than Her Majesty in right of Canada or of a province, a municipality, another registered charity that is not a private foundation, and any club, society or association described in paragraph 149(1)(l)), or

(ii) by a group of persons that do not deal at arm's length with each other, if any any member of the group does not deal at arm's length with a person described in subparagraph (i);

(2) The portion of the description of A in the definition "disbursement quota" in subsection 149.1(1) of the Act before paragraph (*a*) is replaced by the following:

A is 80% of the total of all amounts each of which is the eligible amount of a gift for which the foundation issued a receipt described in subsection 110.1(2) or 118.1(2) in its immediately preceding taxation year, other than

(3) The portion of the description of A.1 in the definition "disbursement quota" in subsection 149.1(1) of the Act before paragraph (*a*) is replaced by the following:

A.1 is 80% of the total of all amounts each of which is the eligible amount of a gift received in a preceding taxation year, to the extent that the eligible amount

(4) The definition "public foundation" in subsection 149.1(1) of the Act is replaced by the following:

"public foundation"
« fondation publique »

"public foundation" means a charitable foundation (*a*) of which more than 50% of the directors, trustees, officers and like officials deal at arm's length with each other and with

(i) each of the other directors, trustees, officers and like officials of the foundation, and

(ii) each person who, and each member of a group of persons who do not deal with each other at arm's length that, has contributed or otherwise paid into the foundation more than 50% of the capital of the foundation (other than Her Majesty in right of Canada or of a province, a municipality, another registered charity that is not a private foundation, and any club, society or association described in paragraph 149(1)(*l*)),

(*b*) that is not, and would not be if the foundation were a corporation, controlled directly or indirectly in any manner whatever

(i) by a person that has contributed or otherwise paid into the foundation more than 50% of the capital of the organization (other than Her Majesty in right of Canada or of a province, a municipality, another registered charity that is not a private foundation, and any club, society or association described in paragraph 149(1)(l)), or

(ii) by a group of persons that do not deal at arm's length with each other, if any any member of the group does not deal at arm's length with a person described in subparagraph (i);

(5) Subsection 149.1(2) of the Act is amended by striking out the word "or" at the end of paragraph (*a*), by adding the word "or" at the end of paragraph (*b*) and by adding the following after paragraph (*b*):

(*c*) makes a disbursement by way of a gift, other than a gift made

(i) in the course of charitable activities carried on by it, or

(ii) to a donee that is a qualified donee at the time of the gift.

(6) Subsection 149.1(3) of the Act is amended by adding the following after paragraph (*b*):

(*b*.1) makes a disbursement by way of a gift, other than a gift made

(i) in the course of charitable activities carried on by it, or

(ii) to a donee that is a qualified donee at the time of the gift;

(7) Subsection 149.1(4) of the Act is amended by adding the following after paragraph (*b*):

(*b*.1) makes a disbursement by way of a gift, other than a gift made

(i) in the course of charitable activities carried on by it, or

(ii) to a donee that is a qualified donee at the time of the gift;

(8) The portion of subsection 149.1(9) of the Act after paragraph (*b*) is replaced by the following:

is, notwithstanding subsection 149.1(8), deemed to be income of the charity for, and the eligible amount of a gift for which it issued a receipt described in subsection 110.1(2) or 118.1(2) in, its taxation year in which the period referred to in paragraph (*a*) expires or the time referred to in paragraph (*b*) occurs, as the case may be.

(9) Paragraph 149.1(15)(*b*) of the Act is replaced by the following:

(*b*) the Minister may make available to the public in such manner as the Minister deems appropriate a listing of all registered, or previously registered, charities and Canadian amateur athletic associations that indicates for each of them

(i) its name and address,

(ii) its registration number and date of registration, and

(iii) the effective date of any revocation, annulment or termination of its registration.

(10) Subsection (1) applies after 1999 except that, in respect of a charitable organization that was not designated as a private foundation or a public foundation under subsection 149.1(6.3) of the Act or under subsection 110(8.1) or (8.2) of the *Income Tax Act*, as enacted by chapter 148 of the Revised Statutes of Canada, 1952, and has not applied after February 15, 1984 for registration under paragraph 110(8)(*c*) of that Act or under the definition "registered charity" in subsection 248(1) of the *Income Tax Act*, subparagraph (*c*)(ii) of the definition "charitable organization" in subsection 149.1(1) of the Act, as enacted by subsection (1), applies after 2004.

(11) Subsections (2) and (3) and (5) to (7) apply to gifts made after ANNOUNCEMENT DATE.

(12) Subsection (4) applies after 1999 except that, in respect of a charitable organization that was not designated as a private

foundation or a charitable organization under subsection 149.1(6.3) of the Act or under subsection 110(8.1) or (8.2) of the *Income Tax Act*, as enacted by chapter 148 of the Revised Statutes of Canada, 1952, and has not applied after February 15, 1984 for registration under paragraph 110(8)(*c*) of that Act or under the definition "registered charity" in subsection 248(1) of the *Income Tax Act*, paragraph (*b*) of the definition "public foundation" in subsection 149.1(1) of the Act, as enacted by subsection (1), is in its application before 2005 to be read

(*a*) without reference to the expression "(other than Her Majesty in right of Canada or of a province, a municipality, another registered charity that is not a private foundation, and any club, society or association described in paragraph 149(1)(*l*))"; and

(*b*) as if the reference to "50%" in that paragraph were read as a reference to "75%".

(13) Subsection (8) applies after ANNOUNCEMENT DATE.

(14) An application referred to in subsection 149.1(6.3) of the *Income Tax Act*, in respect of one or more taxation years after 1999, may be made after 1999 and before the 90th day after this Act is assented to. If a designation referred to in that subsection for any of those taxation years is made in response to the application, the charity is deemed to be registered as a charitable organization, a public foundation or a private foundation, as the case may be, for the taxation years that the Minister of National Revenue specifies.

89. (1) The portion of subsection 152(1.2) of the Act before paragraph (*a*) is replaced by the following:

Provisions applicable

(1.2) Paragraphs 56(1)(*l*) and 60(*o*), this Division and Division J, as they relate to an assessment or a reassessment and to assessing or reassessing tax, apply, with any modifications that the circumstances require, to a determination or a redetermination of an amount under this Division or an amount deemed under section 122.61 to be an overpayment on account of a taxpayer's liability under this Part, except that

(2) Subsections 152(3.4) and (3.5) of the Act are repealed.

(3) Subsections (1) and (2) apply in respect of forms filed after the 90th day after ANNOUNCEMENT DATE.

90. (1) Paragraph 157(3)(*c*) of the Act is replaced by the following:

(*c*) if the corporation is a mutual fund corporation, 1/12 of the total of

(i) the corporation's capital gains refund (within the meaning assigned by section 131) for the year, and

(ii) the amount that, because of subsection 131(5) or, where the corporation is a prescribed labour-sponsored venture capital corporation, because of subsection 131(11), is the corporation's dividend refund (within the meaning assigned by section 129) for the year,

(2) Subsection (1) applies to the 1999 and subsequent taxation years.

91. (1) Subsection 159(3) of the Act is replaced by the following:

Personal liability

(3) If a legal representative (other than a trustee in bankruptcy) of a taxpayer distributes to one or more persons property in the possession or control of the legal representative, acting in that capacity, without obtaining a certificate under subsection (2) in respect of the amounts referred to in that subsection,

(*a*) the legal representative is personally liable for the payment of those amounts to the extent of the value of the property distributed;

(*b*) the Minister may at any time assess the legal representative in respect of any amount payable because of this subsection; and

(*c*) the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, to an assessment made under this subsection as though it had been made under section 152 in respect of taxes payable under this Part.

(2) Subsection (1) applies to assessments made after ANNOUNCEMENT DATE.

92. (1) The portion of subsection 160(1) of the Act after subparagraph (*e*)(i) is replaced by the following:

(ii) the total of all amounts each of which is an amount that the transferor is liable to pay under this Act (including, for greater certainty, an amount that the transferor is liable to pay under this section, regardless of whether the Minister has made an assessment under subsection (2) for that amount) in or in respect of the taxation year in which the property was transferred or any preceding taxation year,

but nothing in this subsection limits the liability of the transferor under any other provision of this Act or of the transferee for the interest that the transferee is liable to pay under this Act on an assessment in respect of the amount that the transferee is liable to pay because of this subsection.

(2) The portion of subsection 160(1.1) of the Act after the description of B is replaced by the following:

but nothing in this subsection limits the liability of the other taxpayer under any other provision of this Act or of any person for the interest that the person is liable to pay under this Act on an assessment in respect of the amount that the person is liable to pay because of this subsection.

(3) Paragraphs 160(1.2) (*a*) and (*b*) of the Act are replaced by the following:

(*a*) carried on a business that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year,

(*b*) was a specified shareholder of a corporation that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year,

(4) Paragraph 160(1.2)(*d*) of the Act is replaced by the following:

(*d*) was a shareholder of a professional corporation that was provided property or services by a partnership or trust all or a portion of the income of which partnership or trust is directly or indirectly included in computing the individual's split income for the year, or

(5) Subsection 160(1.2) of the Act is amended by adding the following after paragraph (*e*):

but nothing in this subsection limits the liability of the specified individual under any other provision of this Act or of the parent for the interest that the parent is liable to pay under this Act on an assessment in respect of the amount that the parent is liable to pay because of this subsection.

(6) Subsection 160(2) of the Act is replaced by the following:

Assessment

(2) The Minister may at any time assess a taxpayer in respect of any amount payable because of this section and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

(7) Subsections (1), (2), (5) and (6) apply in respect of assessments made after ANNOUNCEMENT DATE.

(8) Subsections (3) and (4) apply after ANNOUNCEMENT DATE.

93. (1) Subsection 160.1(3) of the Act is replaced by the following:

Assessment

(3) The Minister may at any time assess a taxpayer in respect of any amount payable by the taxpayer because of subsection (1) or (1.1) or for which the taxpayer is liable because of subsection (2.1) or (2.2), and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section, as though it were made under section 152 in respect of taxes payable under this Part, except that no interest is payable on an amount assessed in respect of an excess referred to in subsection (1) that can reasonably be considered to arise as a consequence of the operation of section 122.5 or 122.61.

(2) Subsection (1) applies to assessments made after ANNOUNCEMENT DATE.

94. (1) The portion of subsection 160.2(1) of the Act after paragraph (*b*) is replaced by the following:

the taxpayer and the last annuitant under the plan are jointly and severally, or solidarily, liable to pay a part of the annuitant's tax under this Part for the year of the annuitant's death equal to that proportion of the amount by which the annuitant's tax for the year is greater than it would have been if it were not for the operation of subsection 146(8.8) that the total of all amounts each of which is an amount determined under paragraph (*b*) in respect of the taxpayer is of the amount included in computing the annuitant's income because of that subsection, but nothing in this subsection limits the liability of the annuitant under any other provision of this Act or of the taxpayer for the interest that the taxpayer is liable to pay under this Act on an assessment in respect of the amount that the taxpayer is liable to pay because of this subsection.

(2) The portion of subsection 160.2(2) of the Act after paragraph (*b*) is replaced by the following:

the taxpayer and the annuitant are jointly and severally, or solidarily, liable to pay a part of the annuitant's tax under this Part for the year of the annuitant's death equal to that proportion of the amount by which the annuitant's tax for the year is greater than it would have been if it were not for the operation of subsection 146.3(6) that the amount determined under paragraph (*b*) is of the amount included in computing the annuitant's income because of that subsection, but nothing in this subsection limits the liability of the annuitant under any other provision of this Act or of the taxpayer for the interest that the taxpayer is liable to pay under this Act on an assessment in respect of the amount that the taxpayer is liable to pay because of this subsection.

(3) Subsection 160.2(3) of the Act is replaced by the following:

Minister may assess recipient

(3) The Minister may at any time assess a taxpayer in respect of any amount payable because of this section and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

(4) Subsections (1) to (3) apply to assessments made after ANNOUNCEMENT DATE.

95. (1) Subsections 160.3(1) and (2) of the Act are replaced by the following:

Liability in respect of amounts received out of or under RCA trust

160.3 (1) If an amount required to be included in the income of a taxpayer because of paragraph 56(1)(*x*) is received by a person with whom the taxpayer is not dealing at arm's length, that person is jointly and severally, or solidarily, liable with the taxpayer to pay a part of the taxpayer's tax under this Part for the taxation year in which the amount is received equal to the amount by which the taxpayer's tax for the year exceeds the amount that would be the taxpayer's tax for the year if the amount had not been received, but nothing in this subsection limits the liability of the taxpayer under any other provision of this Act or of the person for the interest that the person is liable to pay under this Act on an assessment in respect of the amount that the person is liable to pay because of this subsection.

Minister may assess recipient

(2) The Minister may at any time assess a person in respect of any amount payable because of this section and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

(2) Subsection (1) applies to assessments made after ANNOUNCEMENT DATE.

96. (1) Subsection 160.4(1) of the Act is replaced by the following:

Liability in respect of transfers by insolvent corporations

160.4 (1) If property is transferred at any time by a corporation to a taxpayer with whom the corporation does not deal at arm's length at that time and the corporation is not entitled because of subsection 61.3(3) to deduct an amount under section 61.3 in computing its income for a taxation year because of the transfer or because of the transfer and one or more other transactions, the taxpayer is jointly and severally, or solidarily, liable with the corporation to pay the lesser of the corporation's tax payable under this Part for the year and the amount, if any, by which the fair market value of the property at that time exceeds the fair market value at that time of the consideration given for the property, but nothing in this subsection limits the liability of the corporation under any other provision of this Act or of the taxpayer for the interest that the taxpayer is liable to pay under this Act on an assessment in respect of the amount that the taxpayer is liable to pay because of this subsection.

(2) The portion of subsection 160.4(2) of the Act after paragraph (c) is replaced by the following:

the transferee is jointly and severally, or solidarily, liable with the transferor and the debtor to pay an amount of the debtor's tax under this Part equal to the lesser of the amount of that tax that the transferor was liable to pay at that time and the amount, if any, by which the fair market value of the property at that time exceeds the fair market value at that time of the consideration given for the property, but nothing in this subsection limits the liability of the debtor or the transferor under any provision of this Act or of the transferee for the interest that the transferee is liable to pay under this Act on an assessment in respect of the amount that the transferee is liable to pay because of this subsection.

(3) Subsection 160.4(3) of the Act is replaced by the following:

Minister may assess recipient

(3) The Minister may at any time assess a person in respect of any amount payable by the person because of this section and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section, as though it had been made under section 152 in respect of taxes payable under this Part.

(4) Subsections (1) to (3) apply to assessments made after ANNOUNCEMENT DATE.

97. (1) Subsection 162(6) of the French version of the Act is replaced by the following:

Défaut de fournir son numéro d'identification

(6) Toute personne ou société de personnes qui ne fournit pas son numéro d'assurance sociale ou son numéro d'entreprise à la personne – tenue par la présente loi ou par une disposition réglementaire de remplir une déclaration de renseignements devant comporter ce numéro – qui lui enjoint de le fournir est passible d'une pénalité de 100 $ pour chaque défaut à moins que, dans les 15 jours après avoir été enjoint de fournir ce numéro, il ait demandé qu'un numéro d'assurance sociale ou un numéro d'entreprise lui soit attribué et qu'il l'ait fourni à cette personne dans les 15 jours après qu'il l'a reçu.

(2) Subsection (1) applies after June 18, 1998.

98. (1) Paragraph 163(2)(*c*.1) of the Act is replaced by the following:

(*c*.1) the amount, if any, by which

(i) the total of all amounts each of which is an amount that would be deemed by section 122.5 to be paid by that person during a month specified for the year or, where that person is the qualified relation of an individual in relation to that specified month (within the meaning assigned by subsection 122.5(1)), by that individual, if that total were calculated by reference to the information provided in the person's return of income (within the meaning assigned by subsection 122.5(1)) for the year

exceeds

(ii) the total of all amounts each of which is an amount that is deemed by section 122.5 to be paid by that person or by an individual of whom the person is the qualified relation in relation to a month specified for the year (within the meaning assigned to subsection 122.5(1)),

(2) Subsection (1) applies to amounts deemed to be paid during months specified for the 2001 and subsequent taxation years.

99. (1) Section 164 of the Act is amended by adding the following after subsection (1.5):

Where (1.52) applies

(1.51) Subsection (1.52) applies to a taxpayer for a taxation year if, at any time after the beginning of the year

(*a*) the taxpayer has, in respect of the tax payable by the taxpayer under this Part (and, if the taxpayer is a corporation, Parts I.3, VI, VI.1 and XIII.1) for the year, paid under any of sections 155 to 157 one or more instalments of tax,

(*b*) it is reasonable to conclude that the total amount of those instalments exceeds the total amount of taxes that will be payable by the taxpayer under those Parts for the year, and

(*c*) the Minister is satisfied that the payment of the instalments has caused or will cause undue hardship to the taxpayer.

Instalment refund

(1.52) If this subsection applies to a taxpayer for a taxation year, the Minister may refund to the taxpayer all or any part of the excess referred to in paragraph (1.51)(*b*).

Penalties, interest not affected

(1.53) For the purpose of the calculation of any penalty or interest under this Act, an instalment is deemed not to have been paid to the extent that all or any part of the instalment can reasonably be considered to have been refunded under subsection (1.52).

(2) Subsections 164(1.6) of the Act is repealed.

(3) The portion of subsection 164(3) of the Act before paragraph (*a*) is replaced by the following:

Interest on refunds and repayments

(3) If an amount in respect of a taxation year (other than an amount, or a portion of the amount, that can reasonably be considered to arise from the operation of section 122.5 or 122.61) is refunded or repaid under this section to a taxpayer or applied to another liability of the taxpayer, the Minister shall pay or apply interest on it at the prescribed rate for the period that begins on the day that is the latest of

(4) Subsection (2) applies after the 90th day after ANNOUNCEMENT DATE.

(5) Subsection (3) applies in respect of forms filed after the 90th day after ANNOUNCEMENT DATE.

100. (1) Paragraph (*g*) of the definition "financial institution" in subsection 181(1) of Act is replaced by the following:

(*g*) a corporation

(i) listed in the schedule, or

(ii) all or substantially all of the assets of which are shares or indebtedness of financial institutions to which the corporation is related;

(2) Subsection (1) applies after December 22, 1997, but in applying paragraph (*g*) of the definition "financial institution" in

subsection 181(1) of the Act, as enacted by subsection (1), in respect of taxation years that end before ANNOUNCEMENT DATE, that paragraph is to be read as follows:

(*g*) prescribed, or listed in the schedule;

101. (1) Subparagraph 181.2(3)(*g*)(i) of the Act is replaced by the following:

(i) the total of all amounts (other than amounts owing to the member or to other corporations that are members of the partnership) that would, if this paragraph and paragraphs (*b*) to (*d*) and (*f*) applied to partnerships in the same way that they apply to corporations, be determined under those paragraphs in respect of the partnership at the end of its last fiscal period that ends at or before the end of the year

(2) Paragraph 181.2(3)(*i*) of the Act is replaced by the following:

(*i*) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares) at the end of the year,

(3) Subsection 181.2(5) of the Act is replaced by the following:

Value of interest in partnership

(5) For the purposes of subsection (4) and this subsection, the carrying value at the end of a taxation year of an interest of a corporation or of a partnership (each of which is referred to in this subsection as the "member") in a particular partnership is deemed to be the member's specified proportion, for the particular partnership's last fiscal period that ends at or before the end of the taxation year, of the amount that would, if the particular partnership were a corporation, be the particular partnership's investment allowance at the end of that fiscal period.

(4) Subsections (1) and (3) apply to taxation years that begin after ANNOUNCEMENT DATE.

(5) Subsection (2) applies to taxation years that begin after 1995.

(6) In applying paragraphs 181.2(4)(*b*), (*c*) and (*d*.1) of the Act to a particular corporation in respect of an asset that is a loan or an advance to, or an obligation of, another corporation or partnership that the particular corporation holds at the end of a taxation year of the particular corporation that began before ANNOUNCEMENT

DATE, those paragraphs are to be read without reference to the expressions "(other than a financial institution)" and "(other than financial institutions)" if, at the end of the taxation year

(*a*) the particular corporation deals at arm's length with the other corporation or the partnership, as the case may be; and

(*b*) the other corporation is a financial institution, or the partnership is not a partnership described in paragraph 181.2(4)(*d*.1) of the Act, as the case may be, solely because of section 100 and subsections 124(1) and (3).

102. (1) Subparagraph 181.3(3)(*a*)(v) of the Act is replaced by the following:

> (v) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares) at the end of the year, and

(2) Subparagraph 181.3(3)(*b*)(iv) of the Act is replaced by the following:

> (iv) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares) at the end of the year;

(3) Subparagraph 181.3(3)(*c*)(v) of the Act is replaced by the following:

> (v) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares) at the end of the year,

(4) Paragraph 181.3(3)(*c*) of the Act is amended by adding the word "and" at the end of subparagrgph (vi) and by adding the following after that subparagraph:

> (vii) any amount recoverable through reinsurance, to the extent that the amount can reasonably be regarded as being included in the amount determined under subparagraph (iii) in respect of a claims reserve;

(5) Subparagraph 181.3(3)(*d*)(iv) of the Act is amended by striking out the word "and" at the end of clause (D), by replacing

the semi-colon at the end of clause (E) with a comma, and by adding the following after clause (E):

(F) the total of all amounts each of which is an amount recoverable through reinsurance, to the extent that it can reasonably be regarded as being included in the amount determined under clause (A) in respect of a claims reserve; and

(6) Subsections (1) to (5) apply to taxation years that begin after 1995.

103. (1) Subsections 184(2) to (5) of the Act are replaced by the following:

Tax on excessive elections

(2) If a corporation has elected in accordance with subsection 83(2), 130.1(4) or 131(1) in respect of the full amount of any dividend payable by it on shares of any class of its capital stock (in this section referred to as the "original dividend") and the full amount of the original dividend exceeds the portion of the original dividend deemed by that subsection to be a capital dividend or capital gains dividend, as the case may be, the corporation shall, at the time of the election, pay a tax under this Part equal to 3/5 of the excess.

Election to treat excess as separate dividend

(3) If, in respect of an original dividend payable at a particular time, a corporation would, but for this subsection, be required to pay a tax under this Part in respect of an excess referred to in subsection (2), and the corporation elects in prescribed manner on or before the day that is 90 days after the day of mailing of the notice of assessment in respect of the tax that would otherwise be payable under this Part, the following rules apply:

(*a*) the portion of the original dividend deemed by subsection 83(2), 130.1(4) or 131(1) to be a capital dividend or capital gains dividend, as the case may be, is deemed for the purposes of this Act to be the amount of a separate dividend that became payable at the particular time;

(*b*) if the corporation identifies in its election any part of the excess, that part is, for the purposes of any election under subsection 83(2), 130.1(4) or 131(1) in respect of that part, and, where the corporation has so elected, for all purposes of this Act, deemed to be the amount of a separate dividend that became payable immediately after the particular time;

(*c*) the amount by which the excess exceeds any portion deemed by paragraph (*b*) to be a separate dividend for all purposes of this Act is deemed to be a separate taxable dividend that became payable at the particular time; and

(*d*) each person who held any of the issued shares of the class of shares of the capital stock of the corporation in respect of which the original dividend was paid is deemed

(i) not to have received any portion of the original dividend, and

(ii) to have received, at the time that any separate dividend determined under any of paragraphs (*a*) to (*c*) became payable, the proportion of that dividend that the number of shares of that class held by the person at the particular time is of the number of shares of that class outstanding at the particular time except that, for the purpose of Part XIII, the separate dividend is deemed to be paid on the day that the election in respect of this subsection is made.

Concurrence with election

(4) An election under subsection (3) is valid only if

(*a*) it is made with the concurrence of the corporation and all its shareholders

(i) who received or were entitled to receive all or any portion of the original dividend, and

(ii) whose addresses were known to the corporation; and

(*b*) either

(i) it is made on or before the day that is 30 months after the day on which the original dividend became payable, or

(ii) each shareholder described in subparagraph (*a*)(i) concurs with the election, in which case, notwithstanding subsections 152(4) to (5), any assessment of the tax, interest and penalties payable by each of those shareholders for any taxation year may be made that is necessary to take the corporation's election into account.

Exception for non-taxable shareholders

(5) If each person who, in respect of an election made under subsection (3), is deemed by subsection (3) to have received a dividend at a particular time is also, at the particular time, a person all of whose taxable income is exempt from tax under Part I,

(*a*) subsection (4) does not apply to the election; and

(*b*) the election is valid only if it is made on or before the day that is 30 months after the day on which the original dividend became payable.

(2) Subsection (1) applies to original dividends paid by a corporation after its 1999 taxation year except that, for the purpose of subsection 184(5) of the Act, as enacted by subsection (1), an election made before the 90th day after this Act is assented to is deemed to have been made in a timely manner.

104. (1) The description of B in the formula in paragraph 188(1)(*a*) of the Act is replaced by the following:

B is the total of all amounts each of which is the eligible amount of a gift for which it issued a receipt described in subsection 110.1(2) or 118.1(2) in the period (in this section referred to as the "winding-up period") that begins on the valuation day and ends immediately before the payment day, or an amount received by it in the winding-up period from a registered charity,

(2) Subsection (1) applies to gifts made after ANNOUNCEMENT DATE.

105. (1) Subparagraph 190.13(*a*)(v) of the Act is replaced by the following:

(v) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares);

(2) Subparagraph 190.13(*b*)(iv) of the Act is replaced by the following:

(iv) the amount of any deficit deducted in computing its shareholders' equity (including, for this purpose, the amount of any provision for the redemption of preferred shares);

(3) Subsections (1) and (2) apply to taxation years that begin after 1995.

106. (1) Section 191 of the Act is amended by adding the following after subsection (5):

Excluded dividend – partner

(6) If at any time a corporation pays a dividend to a partnership, the corporation is, for the purposes of this subsection and paragraph (*a*) of the definition "excluded dividend" in subsection (1), deemed to have paid at that time to each member of the partnership a dividend equal to the amount determined by the formula

$$A \times B$$

where

A is the amount of the dividend paid to the partnership; and

B is the member's specified proportion for the last fiscal period of the partnership that ended before that time (or, if the partnership's first fiscal period includes that time, for that first fiscal period).

(2) Subsection (1) applies to dividends paid after ANNOUNCEMENT DATE.

107. (1) Subparagraph 191.1(1)(*a*)(i) of the Act is replaced by the following:

(i) 50% of the amount, if any, by which the total of all taxable dividends (other than excluded dividends) paid by the corporation in the year on short-term preferred shares exceeds the corporation's dividend allowance for the year,

(2) Subsection (1) applies to dividends paid by a corporation in its 2003 and subsequent taxation years.

108. (1) Clause 204.81(1)(*c*)(v)(E) of the Act is replaced by the following:

(E) the redemption occurs

(I) more than eight years after the day on which the share was issued, or

(II) if the day that is eight years after that issuance is in February or March of a calendar year, in February or on March 1st of that calendar year but not more than 31 days before that day, or

(2) Section 204.81 of the Act is amended by adding the following after subsection (1):

Corporations incorporated before March 6, 1996

(1.1) In applying clause (1)(*c*)(v)(E), at any time before 2004, in respect of a corporation incorporated before March 6, 1996, the references in that clause to the word "eight" are replaced with references to the word "five" if, at that time, the relevant statements in the corporation's articles refer to the word "five".

Deemed provisions in articles

(1.2) In applying subsection (1), at any time before 2004, to a corporation incorporated before February 7, 2000, if the articles of the corporation comply with subclause (1)(*c*)(v)(E)(I) (as modified, where relevant, by subsection (1.1)), those articles are deemed to provide the statement required by subclause (1)(*c*)(v)(E)(II).

(3) Subsection (1) applies after February 6, 2000 to corporations incorporated at any time.

(4) Subsection (2) applies after February 6, 2000.

109. (1) Clause (*g*)(ii)(D) of the definition « bien étranger » in the French version of subsection 206(1) of the Act is replaced by the following:

(D) la Banque asiatique de développement,

(2) Subparagraphs (*b*)(i) to (iii) of the definition "cost amount" in subsection 206(1) of the Act are replaced by the following:

(i) after 2000 and at or before the end of the taxation year, by the trust in respect of the interest (otherwise than as proceeds of disposition of the interest), and

(ii) that has not been satisfied at or before that time by the issue of new units of the trust or by a payment of an amount by the trust;

(3) The definition "specified proportion" in subsection 206(1) of the Act is repealed.

(4) The portion of subsection 206(3.1) of the French version of the Act before paragraph (*a*) is replaced by the following:

Acquisition d'un titre déterminé

(3.1) Pour ce qui est de l'application du sous-alinéa (2)a)(ii) à un moment donné ou postérieurement, lorsqu'un titre déterminé par rapport à un autre titre est acquis au moment donné par le contribuable mentionné au paragraphe (3.2) relativement au titre et que le titre est un bien étranger à ce moment, les présomptions suivantes s'appliquent :

(5) Subsection (2) applies to months that end after ANNOUNCEMENT DATE.

(6) Subsection (3) applies after ANNOUNCEMENT DATE.

(7) Subsection (4) applies to months that end after 1997.

110. (1) The portion of section 210 of the Act before paragraph (*a*) is replaced by the following:

Designated beneficiary

210. In this Part, a "designated beneficiary" under a particular trust at any time means a beneficiary, under the particular trust, who is at that time

(2) Paragraphs 210(*c*) to (*e*) of the Act are replaced by the following:

(*c*) a person who is, because of subsection 149(1), exempt from tax under Part I on all or part of their taxable income and who acquired an interest in the particular trust after October 1, 1987 directly or indirectly from a beneficiary under the particular trust except if

(i) the interest was, at all times after the later of October 1, 1987 and the day on which the interest was created, owned by persons who were exempt from tax under Part I on all of their taxable income because of subsection 149(1), or

(ii) the person is a trust governed by a registered retirement savings plan or a registered retirement income fund, who acquired the interest, directly or indirectly, from an individual or the spouse or common-law partner, or former spouse or common-law partner, of the individual who was, immediately after the interest was acquired, a beneficiary under the trust governed by the fund or plan;

(*d*) another trust (referred to in this paragraph as the "other trust") that is not a testamentary trust, a mutual fund trust or a trust that is exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income, if any beneficiary under the other trust is at that time

(i) a person or partnership who is, or would if the person or partnership were at that time a beneficiary under the particular trust be, a designated beneficiary under the particular trust because of paragraph (*a*), (*b*), (*c*) or (*e*), or

(ii) a trust that is not

(A) a testamentary trust,

(B) a mutual fund trust,

(C) a trust that is exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income and that is, because of the application of subparagraph (c)(i) or (ii), not a designated beneficiary under the other trust, or

(D) a trust

(I) whose interest, at that time, in the other trust was owned, at all times after the day on which the interest was created, either by it or by persons who were exempt because of subsection 149(1) from tax under Part I on all of their taxable income, and

(II) none of the beneficiaries under which is, at that time, a designated beneficiary under it; or

(*e*) a particular partnership

(i) any of the members of which is, at that time

(A) another partnership, or

(B) a person who is, or would if it were at that time a beneficiary under the particular trust be, a designated beneficiary under the particular trust because of paragraphs (*a*), (*b*) or (*d*), or

(ii) any of the members of which is, at that time, a person exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income except if

(A) the interest of the particular partnership in the particular trust was owned, at all times after the day on which the interest was created, by the particular partnership or by persons who were exempt because of subsection 149(1) from tax under Part I on all of their taxable income, and

(B) none of the members of the particular partnership at that time is a person or partnership described in subparagraph (i).

(2) Subsection (1) applies to the 1996 and subsequent taxation years.

111. (1) Section 210.1 of the Act is amended by replacing the portion before paragraph (*a*) with the following:

Tax not payable

210.1 No tax is payable under this Part for a taxation year by a trust that was throughout the year

(2) Subsection (1) applies to the 1996 and subsequent taxation years.

112. (1) Paragraph 210.2(2)(*b*) of the Act is replaced by the following:

(*b*) the only taxable capital gains and allowable capital losses referred to in paragraph 3(*b*) were from dispositions of

(i) taxable Canadian property, and

(ii) particular property (other than property described in any of subparagraphs 128.1(4)(*b*)(i) to (iii)) if

(A) the particular property (or property for which the particular property is substituted) was transferred at any particular time to a particular trust in circumstances in which subsection 73(1) or 107.4(3) applied, and

(B) either

(I) it is reasonable to conclude that the property was so transferred in anticipation that a person beneficially interested at the particular time in the particular trust would subsequently cease to reside in Canada, and a person beneficially interested at the particular time in the particular trust did subsequently cease to reside in Canada, or

(II) when the property was so transferred the terms of the particular trust satisfied the conditions in subparagraph 73(1.01)(*c*)(i) or (iii), and it is reasonable to conclude that the transfer was made in connection with the cessation of residence, on or before the transfer, of a person who was, at the time of the transfer, beneficially interested in the particular trust and a spouse or common-law partner, as the case may be, of the transferor of the property to the particular trust; and

(2) Subsection (1) applies to dispositions, of property by a trust, that occur after ANNOUNCEMENT DATE.

113. (1) Subparagraph (i) of the description of B in paragraph 211.8(1)(*a*) of the Act is amended by striking out the word "or" at the end of clause (A) and by replacing clause (B) with the following:

(B) more than five years after its issuance, or

(C) if the day that is five years after its issuance is in February or March of a calendar year, in February or on March 1st of that calendar year but not more than 31 days before that day,

(2) Paragraph 211.8(1)(*a*) of the Act is amended by adding the following after subparagraph (i):

(i.1) nil, where the share was issued by a registered labour-sponsored venture capital corporation or a revoked corporation, the original acquisition of the share was after March 5, 1996 and the redemption, acquisition or cancellation is in February or on March 1st of a calendar year but is not more than 31 days before the day that is eight years after the day on which the share was issued,

(3) Subsections (1) and (2) apply to redemptions, acquisitions, cancellations and dispositions that occur after November 15, 1995.

114. (1) Subparagraph 212(1)(*b*)(iv) of the Act is replaced by the following:

(iv) interest payable to a person with whom the payer is dealing at arm's length and to whom a certificate of exemption that is in force on the day the amount is paid or credited was issued under subsection (14),

(2) The portion of subparagraph 212(1)(*b*)(xii) of the Act before clause (A) is replaced by the following:

(xii) interest payable by a lender under a securities lending arrangement, if the lender and the borrower deal with each other at arm's length and the lender is a financial institution prescribed for the purpose of clause (iii)(D), or a registered securities dealer resident in Canada, on money provided to the lender either as collateral or as consideration for the particular security lent or transferred under the arrangement where

(3) Paragraph 212(1)(*b*) of the Act is amended by striking out the word "and" at the end of subparagraph (xi), by adding the word "and" at the end of subparagraph (xii) and by adding the following after subparagraph (xii):

(xiii) an amount paid or credited under a securities lending arrangement that is deemed by subparagraph 260(8)(*a*)(*i*) to be a payment made by a borrower to a lender of interest if

(A) the securities lending arrangement was entered into by the borrower in the course of carrying on a business outside Canada, and

(B) the security that is transferred or lent to the borrower under the securities lending arrangement is described in paragraph (*b*) or (*c*) of the definition "qualified security" in subsection 260(1) and issued by a non-resident issuer;

(4) Paragraph 212(1)(*d*) of the Act is amended by striking out the word "or" at the end of subparagraph (x), by adding the word "or" at the end of subparagraph (xi), and by adding the following after subparagraph (xi):

(xii) an amount to which subsection (5) would apply if that subsection were read without reference to the words "to the extent that the amount relates to that use or reproduction";

(5) Section 212 of the Act is amended by adding the following after subsection (2):

Exempt dividends

(2.1) Subsection (2) does not apply to an amount paid or credited, by a borrower, under a securities lending arrangement if

(*a*) the amount is deemed by subparagraph 260(8)(*a*)(i) to be a dividend;

(*b*) the securities lending arrangement was entered into by the borrower in the course of carrying on a business outside Canada; and

(*c*) the security that is transferred or lent to the borrower under the securities lending arrangement is a share of a class of the capital stock of a non-resident corporation.

(6) Subsection 212(3) is amended by adding the word "and" at the end of paragraph (*a*) and by repealing paragraph (*b*).

(7) Subsection 212(5) of the French version of the Act is replaced by the following:

Films cinématographiques

(5) Toute personne non-résidente doit payer un impôt sur le revenu de 25 % sur toute somme qu'une personne résidant au Canada lui verse ou porte à son crédit, ou est réputée, en vertu de la partie I, lui verser ou porter à son crédit au titre ou en paiement intégral ou partiel d'un droit sur les oeuvres ci-après qui ont été ou doivent être utilisées ou reproduites au Canada, ou d'un droit d'utilisation de telles oeuvres, dans la mesure où la somme se rapporte à cette utilisation ou reproduction :

a) un film cinématographique;

b) un film, une bande magnétoscopique ou d'autres procédés de reproduction à utiliser pour la télévision, sauf ceux utilisés uniquement pour une émission d'information produite au Canada.

(8) The portion of subsection 212(5) of the English version of the Act after paragraph (*b*) is replaced by the following:

that has been, or is to be, used or reproduced in Canada to the extent that the amount relates to that use or reproduction.

(9) Subsection 212(9) of the Act is amended by striking out the word "or" at the end of paragraph (*b*), by adding the word "or" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) a dividend or interest is received by a trust created under a reinsurance trust agreement, to which the Superintendent of Financial Institutions is a party, established in accordance with guidelines issued by the Superintendent relating to reinsurance arrangements with unregistered insurers

(10) Subsection 212(13.2) of the Act is replaced by the following:

Application of Part XIII tax where non-resident operates in Canada

(13.2) For the purposes of this Part, a particular non-resident person, who in a taxation year pays or credits to another non-resident person an amount other than an amount to which subsection (13) applies, is deemed to be a person resident in Canada in respect of the portion of the amount that is deductible in computing the particular non-resident person's taxable income earned in Canada for any taxation year from a source that is neither a treaty-protected business nor a treaty-protected property.

(11) Subparagraph (*b*)(i) of the description of B in subsection 212(19) of the Act is replaced by the following:

> (i) 10 times the greatest amount determined, under the laws of the province or provinces in which the taxpayer is a registered securities dealer, to be the capital employed by the taxpayer at the end of the day, and

(12) Subsection (1) applies to the 1998 and subsequent taxation years.

(13) Subsection (2) applies to arrangements made after 2002.

(14) Subsections (3) and (5) apply to securities lending arrangements entered into after May 1995.

(15) Subsections (4), (7) and (8) apply to the 2000 and subsequent taxation years.

(16) Subsection (6) applies to replacement obligations issued after 2000.

(17) Subsection (9) applies to amounts paid or credited after 2000 to non-resident persons.

(18) Subsection (10) applies to amounts paid or credited after ANNOUNCEMENT DATE.

(19) Subsection (11) applies to securities lending arrangements entered into after May 28, 1993.

115. (1) The portion of subsection 216(1) of the Act before paragraph (*a*) is replaced by the following:

Alternatives re rents and timber royalties

216. (1) If an amount has been paid during a taxation year to a non-resident person or to a partnership of which that person was a member as, on account of, in lieu of payment of or in satisfaction of, rent on real property in Canada or a timber royalty, that person may, within two years (or, if that person has filed an undertaking described in subsection (4) in respect of the year, within six months) after the end of the year, file a return of income under Part I for that year in prescribed form. On so filing and without affecting the liability of the non-resident person for tax otherwise payable under Part I, the non-resident person is, in lieu of paying tax under this Part on that amount, liable to pay tax under Part I for the year as though

(2) The portion of subsection 216(5) of the Act before paragraph (*a*) is replaced with the following:

Disposition by non-resident

(5) If a person or a trust under which a person is a beneficiary has filed a return of income under Part I for a taxation year as permitted by this section or as required by section 150 and, in computing the amount of the person's income under Part I an amount has been deducted under paragraph 20(1)(*a*), or is deemed by subsection 107(2) to have been allowed under that paragraph, in respect of property that is real property in Canada, a timber resource property or a timber limit in Canada, the person shall file a return of income under Part I in prescribed form on or before the person's filing-due date for any subsequent taxation year in which the person is non-resident and in which the person, or a partnership of which the person is a member, disposes of that property or any interest in it. On so filing and without affecting the person's liability for tax otherwise payable under Part I, the person is, in lieu of paying tax under this Part on any amount paid, or deemed by this Part to have been paid, in that subsequent taxation year in respect of any interest in that property to the person or to a partnership of which the person is a member, liable to pay tax under Part I for that subsequent taxation year as though

(3) Subsection 216(7) of the Act is repealed.

(4) Subsections (1) and (2) apply to taxation years that end after ANNOUNCEMENT DATE.

116. (1) Paragraph 230(2)(*a*) of the French version of the Act is replaced by the following:

a) des renseignements sous une forme qui permet au ministre de déterminer s'il existe des motifs de révocation de l'enregistrement de l'organisme ou de l'association en vertu de la présente loi;

(2) Subsection 230(3) of the French version of the Act is replaced by the following:

Ordre du ministre quant à la tenue de registres

(3) Le ministre peut exiger de la personne qui n'a pas tenue les registres et livres de compte voulus pour l'application de la présente loi qu'elle tienne ceux qu'il spécifie. Dès lors, la personne doit tenir les registres et livres de compte qui sont ainsi exigés d'elle.

117. (1) Paragraph 241(4)(*d*) of the Act is amended by striking out the word "or" at the end of subparagraph (xiii) and by adding the following after subparagraph (xiv):

(xv) to a person employed or engaged in the service of an office or agency, of the government of Canada or of a province, whose mandate includes the provision of assistance (as defined by subsection 125.4(1) or 125.5(1)) in respect of film or video productions or film or video production services, solely for the purpose of the administration or enforcement of the program under which the assistance is offered, or

(xvi) to an official of the Canadian Radio-television and Telecommunications Commission, solely for the purpose of the administration or enforcement of a regulatory function of that Commission;

(2) Section 241 of the Act is amended by adding the following after subsection (8):

Information may be communicated

(9) The Minister of Canadian Heritage may communicate or otherwise make available to the public, in any manner that that Minister considers appropriate, the following taxpayer information in respect of a Canadian film or video production certificate (as defined under subsection 125.4(1)) that has been issued or revoked:

(*a*) the title of the production for which the Canadian film or video production certificate was issued;

(*b*) the name of the taxpayer to whom the Canadian film or video production certificate was issued;

(*c*) the names of the producers of the production;

(*d*) the names of the individuals in respect of whom and places in respect of which that Minister has allotted points in respect of the production in accordance with Regulations made for the purpose of section 125.4;

(*e*) the total number of points so allotted; and

(*f*) any revocation of the Canadian film or video production certificate.

118. (1) The definition "common-law partner" in subsection 248(1) of the Act is replaced by the following:

"common-law partner"
« conjoint de fait »

"common-law partner", with respect to a taxpayer at any time, means a person who cohabits at that time in a conjugal relationship with the taxpayer and

(*a*) has so cohabited throughout the twelve-month period that ends at that time, or

(*b*) would be the parent of a child of whom the taxpayer is a parent, if this Act were read without reference to paragraphs 252(1)(c) and (e) and subparagraph 252(2)(*a*)(iii),

and, for the purpose of this definition, where at any time the taxpayer and the person cohabit in a conjugal relationship, they are, at any particular time after that time, deemed to be cohabiting in a conjugal relationship unless they were living separate and apart at the particular time for a period of at least 90 days that includes the particular time because of a breakdown of their conjugal relationship;

(2) Subparagraph (*b*)(i) of the definition "disposition" in subsection 248(1) of the Act is replaced by the following:

(i) where the property is a share, bond, debenture, note, certificate, mortgage, agreement of sale or similar property, or a interest in it, the property is in whole or in part redeemed, acquired or cancelled;

(3) The definition "disposition" in subsection 248(1) of the Act is amended by striking out the word "and" at the end of paragraph (*l*), by adding the word "and" at the end of paragraph (*m*) and by adding the following after paragraph (*m*):

(*n*) a redemption, an acquisition or a cancellation of a share, or of a right to be issued a share, (which share or which right, as the case may be, is referred to in this paragraph as the "security") of the capital stock of a corporation (referred to in this paragraph as the "issuing corporation") held by another corporation (referred to in this paragraph as the "disposing corporation") if

(i) the redemption, acquisition or cancellation occurs as part of a merger or combination of two or more corporations (including the issuing corporation and the disposing corporation) to form one corporate entity (referred to in this paragraph as the "new corporation"),

(ii) the merger or combination is

(A) an amalgamation (within the meaning assigned by subsection 87(1)) to which subsection 87(11) does not apply, or

(B) a foreign merger (within the meaning assigned by subsection 87(8.1)), and

(iii) either

(A) the disposing corporation receives no consideration for the security, or

(B) in the case of a foreign merger (within the meaning assigned by subsection 87(8.1)), the disposing corporation receives no consideration for the security other than property that was, immediately before the foreign merger, owned by the issuing corporation and that, on the foreign merger, becomes property of the new corporation;

(4) The definition "dividend rental arrangement" in subsection 248(1) of the Act is replaced by the following:

"dividend rental arrangement"
« mécanisme de transfert de dividendes »

"dividend rental arrangement", of a person or a partnership (each of which is referred to in this definition as the "person"),

(*a*) means any arrangement entered into by the person where it can reasonably be considered that

(i) the main reason for the person entering into the arrangement was to enable the person to receive a dividend on a share of the capital stock of a corporation, other than a dividend on a prescribed share or on a share described in paragraph (*e*) of the definition "term preferred share" in this subsection or an amount deemed by subsection 15(3) to be received as a dividend on a share of the capital stock of a corporation, and

(ii) under the arrangement someone other than that person bears the risk of loss or enjoys the opportunity for gain or profit with respect to the share in any material respect, and

(*b*) includes, for greater certainty, any arrangement under which

(i) a corporation at any time receives on a particular share a taxable dividend that would, if this Act were read without reference to subsection 112(2.3), be deductible in computing its taxable income or taxable income earned in Canada for the taxation year that includes that time, and

(ii) the corporation or a partnership of which the corporation is a member is obligated to pay to another person or partnership an amount

(A) that is compensation for

(I) the dividend described in subparagraph (i),

(II) a dividend on a share that is identical to the particular share, or

(III) a dividend on a share that, during the term of the arrangement, can reasonably be expected to provide to a holder of the share the same or substantially the same proportionate risk of loss or opportunity for gain as the particular share, and

(B) that, if paid, would be deemed by subsection 260(5) to have been received by that other person or partnership, as the case may be, as a taxable dividend;

(5) Paragraphs (*d*) and (*e*) of the definition "foreign resource property" in subsection 248(1) of the Act are replaced by the following:

(*d*) any right to a rental or royalty computed by reference to the amount or value of production from an oil or gas well in that country, or from a natural accumulation of petroleum or natural gas in that country, if the payer of the rental or royalty has an interest in the well or accumulation, as the case may be, and 90% or more of the rental or royalty is payable out of, or from the proceeds of, the production from the well or accumulation,

(*e*) any right to a rental or royalty computed by reference to the amount or value of production from a mineral resource in that country, if the payer of the rental or royalty has an interest in the mineral resource and 90% or more of the rental or royalty is payable out of, or from the proceeds of, the production from the mineral resource,

(6) Paragraph (*g*) of the definition "foreign resource property" in subsection 248(1) of the Act is replaced by the following:

(*g*) a right to or an interest in any property described in any of paragraphs (a) to (f), other than a right or an interest that the taxpayer has because the taxpayer is a beneficiary under a trust or a member of a partnership;

(7) The portion of the definition "former business property" in subsection 248(1) of the Act before paragraph (*a*) is replaced by the following:

"former business property"
« *ancien bien d'entreprise* »

"former business property", in respect of a taxpayer, means a capital property of the taxpayer that was used by the taxpayer or a person related to the taxpayer primarily for the purpose of gaining or producing income from a business, and that was real property of the taxpayer, an interest of the taxpayer in real property, or a property that is the subject of a valid election under subsection 13(4.2), but does not include

(8) Paragraph (*d*) of the definition « activités de recherche scientifique et de dévéloppement expérimental » in subsection 248(1) of the French version of the Act is replaced by the following:

> *d*) les travaux entrepris par le contribuable ou pour son compte relativement aux travaux de génie, à la conception, à la recherche opérationnelle, à l'analyse mathématique, à la programmation informatique, à la collecte de données, aux essais et à la recherche psychologique, lorsque ces travaux sont proportionnels aux besoins des travaux visés aux alinéas *a*), *b*) ou *c*) qui sont entrepris au Canada par le contribuable ou pour son compte et servent à les appuyer directement.

(9) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"qualifying member"
« associé admissible »

"qualifying member", in respect of a partnership at any time, means a person that is at that time a qualifying member of the partnership for the purposes of subdivision i of Division B because of paragraph 95(2)(*o*);

"specified proportion"
« proportion déterminée »

"specified proportion", of a member of a partnership for a fiscal period of the partnership, means the proportion that the member's share of the total income or loss of the partnership for the partnership's fiscal period is of the partnership's total income or loss for that period and, for the purpose of this definition, where that income or loss for a period is nil, that proportion shall be computed as if the partnership had income for that period in the amount of $1,000,000.

(10) Section 248 of the Act is amended by adding the following after subsection (1):

Non-disposition before December 24, 1998

(1.1) A redemption, an acquisition or a cancellation, at any particular time after 1971 and before December 24, 1998, of a share, or of a right to be issued a share, (which share or which right, as the case may be, is referred to in this subsection as the "security") of the capital stock of a corporation (referred to in this subsection as the "issuing corporation") held by another corporation (referred to in this subsection as the "disposing corporation") is not a disposition (within the meaning of the definition "disposition" in section 54 as that section read in its application to transactions and events that occurred at the particular time) of the security if

(*a*) the redemption, acquisition or cancellation occurred as part of a merger or combination of two or more corporations (including the issuing corporation and the disposing corporation) to form one corporate entity (referred to in this subsection as the "new corporation"),

(*b*) the merger or combination is

(i) an amalgamation (within the meaning assigned by subsection 87(1) as it read at the particular time) to which subsection 87(11) if in force, and as it read, at the particular time did not apply, or

(ii) a foreign merger (within the meaning assigned by subsection 87(8.1) as it read at the particular time), and

(*c*) either

(i) the disposing corporation received no consideration for the security, or

(ii) in the case of a foreign merger (within the meaning assigned by subsection 87(8.1) as it read at the particular time), the disposing corporation received no consideration for the security other than property that was, immediately before the foreign merger, owned by the issuing corporation and that, on the foreign merger, became property of the new corporation.

(11) Subparagraphs 248(16)(*a*)(i) and (ii) of the Act are replaced by the following:

(i) at the particular time that is the earlier of the time that the goods and services tax in respect of the input tax credit was paid and the time that it became payable,

(A) if the particular time is in the reporting period, or

(B) if,

(I) the taxpayer's threshold amount, determined in accordance with subsection 249(1) of the *Excise Tax Act*, is $500,000 or more for the taxpayer's fiscal year (within the meaning assigned by that Act) that includes the particular time, and

(II) the taxpayer claimed the input tax credit at least 120 days before the end of the normal reassessment period, as determined under subsection 152(3.1), for the taxpayer in respect of the taxation year that includes the particular time,

(ii) at the end of the reporting period, if

(A) subparagraph (i) does not not apply, and

(B) the taxpayer's threshold amount, determined in accordance with subsection 249(1) of the *Excise Tax Act*, is less than $500,000 for the fiscal year (within the meaning assigned by that Act) of the taxpayer that includes the particular time, and

(iii) in any other case, on the last day of the taxpayer's earliest taxation year

(A) that begins after the taxation year that includes the particular time, and

(B) for which the normal reassessment period, as determined under subsection 152(3.1), for the taxpayer ends at least 120 days after the time that the input tax credit was claimed; or

(12) The portion of subsection 248(17) of the Act before the reading in quotation marks for subparagraphs 248(16)(*a*)(i) and (ii) is replaced by the following:

Application of subsection (16) to passenger vehicles and aircraft

(17) If the input tax credit of a taxpayer under Part IX of the *Excise Tax Act* in respect of a passenger vehicle or aircraft is determined with reference to subsection 202(4) of that Act, subparagraphs (16)(*a*)(i) to (iii) are to be read as they apply in respect of the passenger vehicle or aircraft, as the case may be, as follows:

(13) Section 248 of the Act is amended by adding the following after subsection (17):

Input tax credit on assessment

(17.1) An amount in respect of an input tax credit that is deemed by subsection 296(5) of the *Excise Tax Act* to have been claimed in a return or application filed under Part IX of that Act is deemed to have been so claimed for the reporting period under that Act that includes the time the Minister makes the assessment referred to in that subsection.

(14) Subparagraph 248(25.3)(*c*)(i) of the Act is replaced by the following:

(i) the particular unit is capital property and the amount is not proceeds of disposition of a capital interest in the trust, or

(15) Section 248 of the Act is amended by adding the following after subsection (29):

Eligible amount of gift

(30) The eligible amount of a gift is the amount by which the fair market value of the property that is the subject of the gift exceeds the amount of the advantage, if any, in respect of the gift.

Amount of advantage

(31) The amount of the advantage in respect of a gift or contribution by a taxpayer is the total of all amounts each of which is the value, at the time the gift or contribution is made, of any property, service, compensation or other benefit that the taxpayer or a person not dealing at arm's length with the taxpayer has received or obtained or is entitled, either immediately or in the future and either absolutely or contingently, to receive or to obtain as partial consideration for, or in gratitude for, the gift or contribution.

Intention to give

(32) The existence of an amount of an advantage in respect of a transfer of property does not in and by itself disqualify the transfer from being a gift if

(*a*) the amount of the advantage does not exceed 80% of the fair market value of the transferred property; or

(*b*) the transferor of the property establishes to the satisfaction of the Minister that the transfer was made with the intention to make a gift.

Cost of property acquired by donor

(33) The cost to a taxpayer of a property, acquired by the taxpayer in circumstances where subsection (31) applies to include the value of the property in computing the amount of the advantage in respect of a gift or contribution, is equal to the fair market value of the property at the time the gift or the contribution is made.

(16) Subsection (1) applies in determining whether a person is, for the 2001 and subsequent taxation years, a common-law partner of a taxpayer.

(17) Subsections (2) and (3) apply to redemptions, acquisitions and cancellations that occur after December 23, 1998 and, where a particular redemption, acquisition or cancellation occurs before [ANNOUNCEMENT DATE + 1], any assessment of a taxpayer's tax, interest and penalties payable under the *Income Tax Act* for a taxation year that includes the time at which the particular redemption, acquisition or cancellation occurred shall, notwithstanding subsections 152(4) to (5) of that Act, be made that is necessary to take into account the application of subsections (2) and (3).

(18) Subsection (4) applies

(*a*) to arrangements made after ANNOUNCEMENT DATE; and

(*b*) to an arrangement made after November 2, 1998 and before [ANNOUNCEMENT DATE + 1] if the parties to the arrangement jointly so elect in writing and file the election with the Minister of National Revenue within 90 days after this Act is assented to.

(19) Subsection (6) applies to property acquired after ANNOUNCEMENT DATE.

(20) Subsection (7) applies in respect of dispositions and terminations that occur after ANNOUNCEMENT DATE.

(21) The definition "qualifying member" in subsection 248(1) of the Act, as enacted by subsection (9), applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999.

(22) The definition "specified proportion" in subsection 248(1) of the Act, as enacted by subsection (9), applies after ANNOUNCEMENT DATE.

(23) In applying subsection 248(1.1) of the Act, as enacted by subsection (10), to a particular redemption, acquisition or cancellation, any assessment of a taxpayer's tax, interest and penalties payable under the *Income Tax Act* for a taxation year that includes the time at which the particular redemption, acquisition or cancellation occurred shall, notwithstanding subsections 152(4) to (5) of that Act, be made that is necessary to take into account the application of subsection (10).

(24) Subsections (11) to (13) apply in respect of input tax credits that become eligible to be claimed in taxation years that begin after ANNOUNCEMENT DATE.

(25) Subsection (14) is applicable to units issued after ANNOUNCEMENT DATE.

(26) Subsection (15) applies in respect of gifts and contributions made after ANNOUNCEMENT DATE.

119. (1) Paragraph 251(1)(*c*) of the Act is replaced by the following:

(*c*) in any other case, it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

(2) Subsection (1) applies after December 23, 1998.

120. (1) Section 253.1 of the Act is replaced by the following:

Investments in limited partnerships

253.1 For the purposes of subparagraph 108(2)(*b*)(ii), paragraphs 130.1(6)(*b*), 131(8)(*b*), 132(6)(*b*), 146.1(2.1)(*c*) and 149(1)(*o*.2), the definition "private holding corporation" in subsection 191(1) and regulations made for the purposes of paragraphs 149(1)(*o*.3) and (*o*.4), if a trust or corporation holds an interest as a member of a partnership and, by operation of any law governing the arrangement in respect of the partnership, the liability of the member as a member of the partnership is limited, the member shall not, solely because of its acquisition and holding of that interest, be considered to carry on any business or other activity of the partnership.

(2) Subsection (1) applies after 1997 except that, for taxation years that end after December 16, 1999 and before 2003, section 253.1 of the Act, as enacted by subsection (1), is to be read as follows:

253.1 For the purposes of subparagraph 108(2)(*b*)(ii), paragraphs 130.1(6)(*b*), 131(8)(*b*), 132(6)(*b*), 146.1(2.1)(*c*) and 149(1)(*o*.2), the definition "private holding corporation" in subsection 191(1) and regulations made for the purposes of paragraphs 149(1)(*o*.3) and (*o*.4), if a trust or corporation is a member of a partnership and, by operation of any law governing the arrangement in respect of the partnership, the liability of the member as a member of the partnership is limited, the member is deemed

(*a*) to undertake an investing of its funds because of its acquisition and holding of its interest as a member of the partnership; and

(*b*) not to carry on any business or other activity of the partnership.

121. (1) Subparagraph 256(6)(*b*)(ii) of the French version of the Act is replaced by the following:

(ii) soit à des actions du capital-actions de la société contrôlée qui appartenaient à l'entité dominante au moment donné et qui, selon la convention ou l'arrangement, devaient être rachetées par la société contrôlée ou achetées par la personne ou le groupe de personnes visé au sous-alinéa *a*)(ii).

(2) Subparagraph 256(7)(*a*)(i) of the Act is amended by striking out the word "or" at the end of clause (C) and by adding the following after clause (D):

(E) a corporation on a distribution (within the meaning assigned by subsection 55(1)) by a specified corporation (within the meaning assigned by that subsection) if a dividend, to which subsection 55(2) does not apply because of paragraph 55(3)(*b*), is received in the course of the reorganization in which the distribution occurs,

(3) Paragraph 256(7)(*a*) of the Act is amended by adding the word "or" at the end of subparagraph (ii) and by adding the following after subparagraph (ii):

(iii) the acquisition at any time of shares of the particular corporation if

(A) the acquisition of those shares would otherwise result in the acquisition of control of the particular corporation at that time by a related group of persons, and

(B) each member of each group of persons that controls the particular corporation at that time was related (otherwise than because of a right referred to in paragraph 251(5)(*b*)) to the particular corporation immediately before that time;

(4) Paragraph 256(7)(*e*) of the Act is replaced by the following:

(*e*) control of a particular corporation and of each corporation controlled by it immediately before a particular time is deemed not to have been acquired at the particular time by a corporation (in this paragraph referred to as the "acquiring corporation") if at the particular time, the acquiring corporation acquires shares of the particular corporation's capital stock for consideration that consists solely of shares of the acquiring corporation's capital stock, and if

(i) immediately after the particular time

(A) the acquiring corporation owns all the shares of each class of the particular corporation's capital stock (determined without reference to shares of a specified class, within the meaning assigned by paragraph 88(1)(*c*.8)),

(B) the acquiring corporation is not controlled by any person or group of persons, and

(C) the fair market value of the shares of the particular corporation's capital stock that are owned by the acquiring corporation is not less than 95% of the fair market value of all of the assets of the acquiring corporation, or

(ii) any of clauses (i)(A) to (C) do not apply and the acquisition occurs as part of a plan of arrangement that, upon completion, results in

(A) the acquiring corporation (or a new corporation that is formed on an amalgamation of the acquiring corporation and a subsidiary wholly-owned corporation of the acquiring corporation) owning all the shares of each class of the particular corporation's capital stock (determined without reference to shares of a specified class, within the meaning assigned by paragraph 88(1)(*c*.8)),

(B) the acquiring corporation (or the new corporation) not being controlled by any person or group of persons, and

(C) the fair market value of the shares of the particular corporation's capital stock that are owned by the acquiring corporation (or the new corporation) being not less than 95% of the fair market value of all of the assets of the acquiring corporation (or the new corporation).

(5) Subsections (2) and (3) apply to acquisitions of shares that occur after 2000.

(6) Subsection (4) applies in respect of shares acquired after 1999.

122. (1) The portion of subsection 259(1) of the Act before paragraph (*a*) is replaced by the following:

Proportional holdings in trust property

259. (1) For the purposes of subsections 146(6), (10) and (10.1), 146.1(2.1) and 146.3(7), (8) and (9) and Parts X, X.2, XI and XI.1, if at any time a taxpayer described in section 205 acquires, holds or disposes of a particular unit in a qualified trust and the trust elects for any period that includes that time to have this subsection apply,

(2) Subsection (1) applies to the 2000 and subsequent taxation years.

123. (1) Paragraph (*a*) of the definition "securities lending arrangement" in subsection 260(1) of the Act is replaced by the following:

(*a*) a person (in this section referred to as the "lender") transfers or lends at any particular time a qualified security to another person (in this section referred to as the "borrower"),

(2) The definition "securities lending arrangement" in subsection 260(1) of the Act is amended by striking out the word "and" at the end of paragraph (*c*), by adding the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*e*) if the lender and the borrower do not deal with each other at arm's length, it is not intended that the arrangement, nor any series of securities lending arrangements, loans or other transactions of which the arrangement is a part, be in effect for more than 270 days,

(3) Paragraph 260(6.1)(*a*) of the English version of the Act is replaced by the following:

(*a*) the amount that the corporation is obligated to pay to another person under an arrangement described in paragraph (*b*) of the definition "dividend rental arrangement" in subsection 248(1) that, if paid, would be deemed by subsection (5) to have been received by another person as a taxable dividend, and

(4) Subsection 260 of the Act is amended by adding the following after subsection (9):

Partnerships

(10) For the purpose of this section,

(*a*) a person includes a partnership; and

(*b*) a partnership is deemed to be a registered securities dealer if each member of the partnership is a registered securities dealer.

Corporate members of partnerships

(11) A corporation that is, in a taxation year, a member of a partnership is deemed,

(*a*) for the purpose of applying subsection (5) in respect of the taxation year,

(i) to receive its specified proportion, for the last fiscal period of the partnership that ends in the taxation year, of any amount received by the partnership in that fiscal period, and

(ii) in respect of the receipt of its specified proportion of that amount, to be the same person as the partnership;

(*b*) for the purpose of applying paragraph (6.1)(*a*) in respect of the taxation year, to be obligated to pay its specified proportion, for the last fiscal period of the partnership that ends in the taxation year, of the amount the partnership is obligated to pay to another person under the arrangement described in that paragraph; and

(*c*) for the purpose of applying section 129 in respect of the taxation year, to have paid

(i) if the partnership is not a registered securities dealer, the corporation's specified proportion, for the last fiscal period of the partnership that ends in the taxation year, of each amount paid by the partnership (other than an amount for which a deduction in computing income may be claimed under subsection (6.1) by the corporation), and

(ii) if the partnership is a registered securities dealer, 1/3 of the corporation's specified proportion, for the last fiscal period of the partnership that ends in the taxation year, of each amount paid by the partnership (other than an amount for which a deduction in computing income may be claimed under subsection (6.1) by the corporation).

(5) Subsections (1) and (2) apply to arrangements made after 2002.

(6) Subsections (3) and (4) apply

(*a*) to arrangements made after ANNOUNCEMENT DATE; and

(*b*) to an arrangement made after November 2, 1998 and before [ANNOUNCEMENT DATE + 1] if the parties to the arrangement have made the election described in paragraph 118(18)(*b*).

124. (1) The Act is amended by adding the following after section 260:

SCHEDULE

(Subsection 181(1))

Listed Corporations

AmeriCredit Financial Services of Canada Ltd.

Associates Capital Corporation of Canada/Corporation de capital associés du Canada

AVCO Financial Services Quebec Limited

Bombardier Capital Ltd.

Canaccord Capital Credit Corporation/Corporation de crédit Canaccord capital

Canadian Cooperative Agricultural Financial Services

Canadian Home Income Plan Corporation

Citibank Canada Investment Funds Limited.

Citicapital Commercial Corporation/Citicapital Corporation Commerciale

CitiFinancial Canada, Inc./CitiFinancière Canada, Inc.

CitiFinancial Mortgage Corporation/CitiFinancière, corporation de prêts hypothécaires

CitiFinancial Services of Canada East Company/CitiFinancière, compagnie de services du Canada est

CitiFinancial Services of Canada Ltd./CitiFinancière, services du Canada Ltée

Crédit Industriel Desjardins

CU Credit Inc.

Farm Credit Canada

Ford Credit Canada Limited

GE Card Services Canada Inc./GE Services de Cartes du Canada Inc.

General Motors Acceptance Corporation of Canada Limited

Household Commercial Canada Inc.

Household Finance Corporation of Canada

Household Finance Corporation Limited

Household Realty Corporation Limited

Hudson's Bay Company Acceptance Limited

John Deere Credit Inc./Crédit John Deere Inc.

Merchant Retail Services Limited

PACCAR Financial Ltd./Compagnie Financière Paccar Ltée

Paradigm Fund Inc./Le Fonds Paradigm Inc.

Prêts étudiants Acadie Inc./Acadia Student Loans Inc.

Principal Fund Incorporated

RT Mortgage-Backed Securities II Limited

RT Mortgage-Backed Securities Limited

Trans Canada Credit Corporation

Trans Canada Retail Services Company/Société de services de détails trans Canada

VNB Financial Services Inc./Services financiers VNB, Inc.

Wells Fargo Financial Canada Corporation

(2) Subject to subsection (3), subsection (1) is deemed to have come into force on ANNOUNCEMENT DATE.

(3) Subsection (1) is deemed to have come into force to enact the schedule referred to in that subsection so as to, on the dates set out below, list each of the following corporations in the schedule:

(*a*) AmeriCredit Financial Services of Canada Ltd., after June 29, 2001;

(*b*) Associates Capital Corporation of Canada/Corporation de capital associés du Canada, after 1997;

(*c*) Canaccord Capital Credit Corporation/Corporation de crédit Canaccord capital, after September 24, 2000;

(*d*) Citibank Canada Investment Funds Limited, after December 30, 2001;

(*e*) Citicapital Commercial Corporation/Citicapital Corporation Commerciale, after 1999 except that, in its application before July 2001, the reference in the schedule to that corporation is to be read as a reference to "Associates Commercial Corporation of Canada Ltd./Les Associés, Corporation Commerciale du Canada Ltee";

(*f*) CitiFinancial Canada, Inc./CitiFinancière Canada, Inc., after 1997 except that, in its application before June 1999, the reference in the schedule to that corporation is to be read as a reference to "Commercial Credit Corporation CCC Limited/Corporation De Credit Commerciale CCC Limitee";

(*g*) CitiFinancial Services of Canada East Company/CitiFinancière, compagnie de services du Canada Est, after December 22, 1997 except that, in its application

(i) after September 26, 1999 and before May 2001, the reference in the schedule to that corporation is to be read as a reference to "Associates Financial Services of Canada East Company/Les Associés, Compagnie de Services Financiers du Canada Est",

(ii) after February 12, 1998 and before September 27, 1999, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Canada East Company/Compagnie Services Financiers Avco Canada Est",

(iii) after December 29, 1997 and before February 13, 1998, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Canada East Company/Services Financiers Avco Canada Est Compagnie", and

(iv) before December 30, 1997, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Canada East Company";

(*h*) CitiFinancial Mortgage Corporation/CitiFinancière, corporation de prêts hypothécaires, after March 1, 1998, except that, in its application before May 2001, the reference in the schedule to that corporation is to be read as "Associates Mortgage Corporation/Les Associés, Corporation de Prêts Hypothécaires";

(*i*) CitiFinancial Mortgage East Corporation/CitiFinancière, corporation de prêts hypothocaires de l'Est, after December 22, 1997, except that, in its application

(i) after November 2, 1999 and before May 2001, the reference in the schedule to that corporation is to be read as a reference to "Associates Mortgage East Corporation/Les Associés, Corporation de Prêts Hypothécaires de l'Est",

(ii) after September 27, 1999 and before November 3, 1999, the reference in the schedule to that corporation is to be read as a reference to "Associates Mortgage East Corporation/Les Associés, Corporation de Financiers du Prêts Hypothécaires de l'Est",

(iii) after February 12, 1998 and before September 28, 1999, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Realty East Company/Compagnie Services Financiers Immobiliers Avco Est",

(iv) after December 29, 1997 and before February 13, 1998, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Realty East Company/Services Financiers Immobiliers Avco Est Compagnie", and

(v) before December 30, 1997, the reference in the schedule to that corporation is to be read as a reference to "Avco Financial Services Realty East Company";

(*j*) CitiFinancial Services of Canada Ltd./CitiFinancière, services du Canada Ltée, after March 1, 1998 except that, in its application before May 2001, the reference in the schedule to that corporation is to be read as "Associates Financial Services of Canada Ltd./Les Associés, Services Financières du Canada Ltée";

(*k*) Ford Credit Canada Limited, after June 1989;

(*l*) GE Card Services Canada Inc./GE Services de Cartes du Canada Inc., after August 1, 2000;

(*m*) John Deere Credit Inc./Crédit John Deere Inc., after 1998;

(*n*) PACCAR Financial Ltd./Compagnie Financière Paccar Ltée, after December 30, 2000;

(*o*) Paradigm Fund Inc./Le Fonds Paradigm Inc., after 2001;

(*p*) Prêts étudiants Acadie Inc./Acadia Student Loans Inc., after 1997;

(*q*) Trans Canada Retail Services Company/Société de services de détails trans Canada, after 1998 except that, in its application before January 15, 2002, the reference in the schedule to that corporation is to be read as "National Retail Credit Services Company/Société de services de credit aux détaillants national";

(*r*) VNB Financial Services Inc./Services financiers VNB, Inc., after 2001; and

(*s*) Wells Fargo Financial Canada Corporation, after 1998, except that, in its application before September 7, 2001, the reference in the schedule to that corporation is to be read as a reference to "Norwest Financial Canada Company".

CONSEQUENTIAL AMENDMENTS

Federal-Provincial Fiscal Arrangements Act

125. (1) Paragraph 12.2(1)(*b*) of the *Federal-Provincial Fiscal Arrangements Act* is replaced by the following:

(*b*) the Act of the legislature of the province imposing a tax on the income of corporations provides, in the opinion of the Minister, for a deduction in computing taxable income of a corporation for taxation years ending in the fiscal year of an amount that is not less than the amount deductible by the corporation for the year under paragraph 110(1)(*k*) of the *Income Tax Act*.

(2) Subsection (1) applies after 2003.

Income Tax Amendments Act, 2000

126. (1) Subsection 59(2) of the *Income Tax Amendments Act, 2000* is replaced by the following:

(2) Subsection (1) applies to taxation years that end after February 27, 2000 except that, for a taxation year of a debtor that includes either February 28, 2000 or October 17, 2000 or began after February 28, 2000 and ended before October 17, 2000, the reference to the fraction "1/2" in subsection 80.01(10) of the Act, as enacted by subsection (1), shall be read as a reference to the fraction in paragraph 38(*a*) of the Act that applied to the debtor for the year in which the commercial debt obligation was deemed to have been settled.

(2) Subsection (1) is deemed to have come into force on June 14, 2001.

127. (1) Subsection 70(11) of the Act is replaced by the following:

(11) Subsections (4), (5) and (7) apply to taxation years that end after February 27, 2000 except that, for a taxation year of a taxpayer that includes February 28, 2000 or October 17, 2000, or began after February 28, 2000 and ended before October 17, 2000, the references to the word "twice" in subsection 93(1.2) of the Act, as enacted by subsection (4), in subsection 93(2) of the Act, as enacted by subsection (5), and in subsection 93(2.2) of the Act, as enacted by subsection (7), shall be read as references to the expression "the fraction that is the reciprocal of the fraction in paragraph 38(*a*) of the Act, as enacted by subsection 22(1) of the *Income Tax Amendments Act, 2000*, that applies to the taxpayer for the year, multiplied by".

(2) Subsection (1) is deemed to have come into force on June 14, 2001.

Explanatory Notes

PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act* and related Acts. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable John Manley, P.C., M.P.
Deputy Prime Minister and Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act* and related Acts. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Clause 1

Income or Loss from a Source or from Sources in a Place – Deductions Applicable

ITA
4(3)(*a*)

Subsection 4(2) of the *Income Tax Act* provides that, in determining the income or loss from a source, no deductions are permitted under sections 60 to 64 of the Act. Subsection 4(3) provides that this rule does not apply, with the exception of certain deductions, in determining the foreign source income designated by a trust to a beneficiary under subsections 104(22) and 104(22.1), in determining a taxpayer's taxable income earned in Canada under section 115 and in determining a taxpayer's foreign tax credit under section 126 of the Act. The exceptions are for deductions permitted by paragraphs 60(*b*) to (*o*), (*p*), (*r*) and (*v*) to (*w*).

Paragraph 4(3)(*a*) is amended to expand the list of exceptions to include deductions permitted by paragraph 60(*x*) (repayment of Canada Education Savings Grants).

This amendment applies to the 2002 and subsequent taxation years.

Clause 2

Employment Income

ITA
6

Section 6 of the Act deals with employment income. The section provides for the inclusion in an employee's income of most employment-related benefits other than those specifically excluded.

Forgiven Amount

ITA
6(15.1)

Subsection 6(15) of the Act provides that, for the purpose of paragraph 6(1)(*a*), the value of the benefit derived from the forgiveness of a debt is the forgiven amount in respect of the obligation. Subsection 6(15.1) of the Act provides that, for the purpose of subsection 6(15), the expression "forgiven amount" in respect of an obligation has the meaning that would be assigned by subsection 80(1) of the Act if certain assumptions were made.

Subsection 6(15.1) of the French version of the Act refers to conditions that must be met in order for the provision to apply. This statement could be interpreted as requiring that the obligation referred to in the preamble of subsection 6(15.1) be a commercial obligation. In order to avoid this interpretation, the French version of subsection 6(15.1) is amended to clarify that the statements made in paragraphs (*a*) to (*d*) are assumptions and not conditions.

This amendment applies to taxation years that end after February 21, 1994.

Clause 3

Employee Security Options – Definitions

ITA
7(7)

Section 7 of the Act deals with agreements (generally referred to a stock options) under which employees of a corporation or mutual fund trust acquire rights to acquire securities of the employer (or a person with whom the employer does not deal at arm's length).

Subsection 7(7) of the Act defines the expressions "qualifying person" and "security" for the purposes of section 7 and certain other provisions of the Act relating to those agreements. "Qualifying person" is defined as a corporation or a mutual fund trust. "Security" is defined as a share issued by a corporation or a unit of a mutual fund trust.

Subsection 7(7) is amended to have these definitions also apply for the purposes of new subsections 110(1.7) and (1.8) of the Act. New subsection 110(1.7) ensures that a reduction in the exercise price under an employee security option will not disqualify the employee from claiming the security option deduction under paragraph 110(1)(*d*) of the Act, provided certain conditions are met. New subsection 110(1.8) sets out the conditions that must be met in order for new subsection 110(1.7) to apply.

This amendment, which applies after 1998, is consequential to the enactment of new subsections 110(1.7) and (1.8). For additional information, see the commentary to those subsections.

Clause 4

Income from Office or Employment – Deductions

ITA
8

Section 8 of the Act provides for the deduction of various amounts in computing income from an office or employment.

Legal Expenses of Employee

ITA
8(1)(*b*)

Paragraph 8(1)(*b*) of the Act allows the deduction of amounts paid by the taxpayer to collect or establish a right to salary or wages owed to the taxpayer by the taxpayer's employer or former employer.

Concern has been expressed that where an amount is not owed to the employee directly by the employer, any legal expenses incurred by the taxpayer would not be deductible under paragraph 8(1)(*b*), even though the amount, when received, would be taxable as employment income. This would be the case, for example, with respect to legal fees incurred by a taxpayer to collect insurance benefits under a sickness or accident insurance policy provided through an employer.

Paragraph 8(1)(*b*) is amended, effective for amounts paid after 2000, to allow a deduction for legal expenses incurred by a taxpayer to collect, or establish a right to collect, an amount that, if received, would be included in computing the taxpayer's employment income.

Dues and Other Expenses of Performing Duties

ITA
8(1)(*i*)

Paragraph 8(1)(*i*) of the Act permits an employee to deduct certain dues and other employment expenses that are paid by the employee. Paragraph 8(1)(*i*) is amended, applicable on Royal Assent, to clarify that an expense described in that paragraph that is paid on an employee's behalf is deductible by the employee if the amount paid is required to be included in computing the employee's income.

Clause 5

Income Inclusions

ITA
12

Section 12 of the Act provides for the inclusion of various amounts in computing the income of a taxpayer from a business or property.

Royalties, etc.

ITA
12(1)(*o*)

Paragraph 12(1)(*o*) of the Act requires a taxpayer to include in income, for a taxation year, certain amounts that become receivable in the year by the Crown or an emanation of the Crown. Paragraph 12(1)(*o*) is amended to eliminate the requirement that the obligation under which the amount becomes receivable, be imposed by statute or by a contractual obligation substituted for an obligation imposed by statute. This amendment, which applies to amounts that become receivable after Announcement Date, eliminates any interpretive difficulties that may be associated with the phrase "a contractual obligation substituted for an obligation imposed by statute". Exemptions will continue to be prescribed by section 1211 of the *Income Tax Regulations* for amounts described in paragraph 12(1)(*o*) for which it would be inappropriate to require an inclusion in income.

No Deferral of Section 9 Under Paragraph (1)(*g*)

ITA
12(2.01)

New subsection 12(2.01) of the Act, which comes into force on Royal Assent, provides that paragraph 12(1)(*g*) of the Act does not defer the inclusion in a taxpayer's income of an amount that would otherwise be so included at an earlier time in accordance with section 9 of the Act. Accordingly, where an amount based on production or use would be included in computing a taxpayer's income from a business or property (if section 12 were read without reference to paragraph 12(1)(*g*)) at a time when the amount is accrued but not yet received, subsection 12(2.01) clarifies that paragraph 12(1)(*g*) does not apply to defer the inclusion of the amount in income until the time of receipt.

Clause 6

Depreciable Property

ITA
13

Section 13 of the Act provides a number of special rules related to the treatment of depreciable property. Generally, these rules apply for the purposes of sections 13 and 20 of the Act and the capital cost allowance regulations.

Recaptured Depreciation

ITA
13(1)

Subsection 13(1) of the Act provides for the inclusion in a taxpayer's income of recaptured capital cost allowance when the taxpayer's proceeds of disposition of depreciable property of a prescribed class exceeds the undepreciated capital cost (UCC) of the property.

Subsection 13(1) is amended to add a reference to new descriptions D.1 and K of the definition "undepreciated capital cost" in subsection 13(21). Those descriptions provide for an addition to the UCC of a class of certain countervailing duties paid in respect of property of the class ("D.1") and a corresponding reduction for any refunds of those amounts ("K").

This amendment applies to taxation years that end after February 23, 1998, and corrects a technical deficiency.

Exchanges of Property

ITA
13(4)(*c*)(ii)

Subsection 13(4) of the Act allows a taxpayer, who is required under subsection 13(1) to include in income recaptured depreciation resulting from the disposition of certain depreciable property, to elect to defer tax on the recapture to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time, namely

- in the case of certain involuntary dispositions, e.g., theft or expropriation, before the end of the taxpayer's second taxation year that begins after the property was disposed of, or

- in other situations, before the end of the taxpayer's first taxation year that begins after the property was disposed of.

Subparagraph 13(4)(*c*)(ii) is amended to accommodate taxation years that are shorter than 12 months, by providing that the periods for acquiring replacement property end at the later of the times mentioned above and

- in the case of involuntary dispositions, within 24 months after the end of the taxation year in which the property was disposed of, or

- in other situations, within 12 months after the end of the taxation year in which the property was disposed of.

These amendments apply, in the case of involuntary dispositions, in respect of dispositions that occur in taxation years that end on or after the day that is 24 months before Announcement Date, and in any other case, in respect of dispositions that occur in taxation years that end on or after the day that is 12 months before Announcement Date.

Election – Limited Period Franchise, Concession or License

ITA
13(4.2) and (4.3)

Subsection 14(6) of the Act permits a taxpayer to defer tax otherwise arising on the disposition of an eligible capital property, to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time. A franchise, concession or license with an indefinite term may be such an eligible capital property. However, such a property with a defined term will generally be a depreciable property included in Class 14 of Schedule II of the Regulations and will not be eligible for similar replacement treatment under subsection 13(4) of the Act because such a property is not a "former business property" as defined in subsection 248(1) of the Act. Further, the replacement property provisions for depreciable property generally apply only to immoveable property.

New subsections 13(4.2) and (4.3) of the Act are added, concurrent with the amendment of the definition "former business property", to allow a taxpayer (the "transferor") to use the replacement property rules under subsection 13(4) in respect of the disposition or termination of a property that is the subject of a joint election with the purchaser (the "transferee") of the property.

New subsection 13(4.2) describes the circumstances under which the transferor and the transferee may make a joint election. Property eligible for the election is a "former property" described in subsection 13(4) that is a franchise, concession or license for a limited period that is wholly attributable to the carrying on of a business at a fixed place. The election may be made where the property is disposed of directly by the transferor to the transferee or where the property of the transferor is terminated and the transferee acquires a similar property in respect of the same fixed place from another person. Both parties must elect in their returns of income for their respective taxation years that include the year of the disposition or termination.

New subsection 13(4.3) provides rules that apply when an election has been made under subsection 13(4.2). If the transferee acquires the property disposed of by the transferor (the "former property"), the transferee is deemed to own that property until such time as the transferee owns neither the former property nor a similar property in respect of the same fixed place to which the former property related. If the transferee instead acquires a similar property in respect of the same fixed place (i.e., the life of the former property was terminated), the transferee is deemed to have also acquired the former property and to continue to own it until the transferee no longer owns the similar property.

In either case, for the purpose of claiming a deduction by the transferee under paragraph 20(1)(*a*) of the Act, the life of the former property in the hands of the transferee is deemed to be the term remaining at the time the transferor originally acquired the property. For instance, a license with a 20-year life when it was originally acquired by the transferor, but with 5 years remaining at the time of the transfer, would be considered to have a 20 year life in the hands of the transferee for the purposes of claiming a deduction under paragraph 20(1)(*a*).

There may be circumstances where, but for an election under subsection 13(4.2), a portion of the consideration given by a transferee upon the sale of a limited period franchise, license or concession might reasonably be considered to be an eligible capital amount to the transferor and an eligible capital expenditure to the transferee. For instance, a portion of the consideration may reasonably relate to the preferred status that the transferee may receive in obtaining a new property at the end of the term. Where an election under subsection 13(4.2) is made, subsection 13(4.3) provides that such an amount will be neither an eligible capital amount to the transferor, nor an eligible capital expenditure to the transferee, but will instead be included in the cost to the transferee and proceeds of disposition of the transferor of the former property.

In this regard, it is also proposed that section 1101 of the Regulations be amended, applicable after Announcement Date, by adding the following after subsection (1*af*):

> (1*ag*) If more than one property of a taxpayer is described in the same class in Schedule II, and one or more of the properties is a property in respect of which the taxpayer is a transferee that has elected under subsection 13(4.2) of the Act, a separate class is prescribed for each such property of the taxpayer that would otherwise be included in the same class.

If, subsequent to the acquisition of the former property by the transferee, the life of the former property expires and a similar property in respect of the same fixed place is not acquired by the transferee, the transferee may, under subsection 20(16) of the Act, be entitled to a terminal loss in respect of the former property. Refer to the commentary to new paragraph 20(16.1)(*b*) of the Act regarding limitations in respect of the deduction of such a terminal loss.

New subsections 13(4.2) and (4.3) apply in respect of dispositions and terminations that occur after Announcement Date.

Example 1

Ms. Mubarak is a franchisee with 5 years remaining of a 20-year agreement. The original cost was $60,000, and the undepreciated capital cost ("UCC") is $15,000. The agreement is transferable, so she agrees to sell the franchise to Mr. Grando at its fair market value of $85,000. Ms. Mubarak will, in the same taxation year, purchase from Ms. Vincent a replacement franchise that has 15 years remaining of a 20-year term, for $100,000.

But for the making of an election under subsection 13(4.2), Ms. Mubarak would have a capital gain of $25,000 (i.e., $85,000 - $60,000) and a UCC balance of $55,000 (i.e., $15,000 + $100,000 - $60,000) before deducting any capital cost allowance for the *year. The adjusted cost base ("ACB") of her replacement franchise would be $100,000. Mr. Grando would have acquired a Class 14 property with an ACB and capital cost of $85,000, depreciable over 5 years.*

If Ms. Mubarak and Mr. Grando jointly elect under subsection 13(4.2), Ms. Mubarak may elect under subsections 13(4) and 44(1) to defer the capital gain, such that the ACB and capital cost of the replacement franchise will be deemed to be $75,000 (i.e., $100,000 less the $25,000 deferred capital gain). Furthermore, Ms. Mubarak's UCC balance for Class 14 will be $30,000 (i.e., an increase equivalent to the $100,000 cost of the replacement franchise less the $85,000 proceeds from the former property), to be amortized over the remaining 15-year term. In this regard, note that the term for amortizing Ms. Mubarak's replacement franchise is unaffected by her and Mr. Grando's joint election in respect of the former property. Mr. Grando, on the other hand, will be required to amortize his $85,000 cost of the former property over 20 years, which was the term of the former property when it was first acquired by Ms. Mubarak.

If Mr. Grando does not enter into a new agreement with the franchisor after the 5-year period, he will be eligible for a terminal loss (even if there are other Class 14 assets, because the $85,000 property will be in a "separate class"). However, a terminal loss will not be available if a person dealing non-arm's length with Mr. Grando, at any time before the time that is 24 months after the expiry of the old agreement, enters into a new franchise agreement in respect of the same fixed place.

Example 2

Consider the same example, except that the original franchise agreement of Ms. Mubarak (the former property) is not transferable, but instead must be terminated and renewed with the franchisor. Suppose that it is renewed by Mr. Grando for a period of 12 years, with an additional amount of $120,000 paid by Mr. Grando to the franchisor for the new agreement.

In this case it is arguable that, for Mr. Grando, the $85,000 payment to Ms. Mubarak is, absent an election under subsection 13(4.2), an eligible capital expenditure by Mr. Grando. That is, *Mr. Grando will pay a separate amount of $120,000 to the franchisor for a Class 14 asset, but the $85,000 payment to Ms. Mubarak is, in effect, incurred to acquire the right to renew the franchise, not to acquire a Class 14 property. Ms. Mubarak has likewise received proceeds of disposition of an eligible capital property (i.e., an "eligible capital amount", 3/4 of which would reduce her CEC balance), not proceeds of disposition of a Class 14 property. Absent an election under subsection 13(4.2), Ms. Mubarak would not be entitled to acquire a replacement eligible capital property, but could be entitled to claim a terminal loss on the termination of the original franchise agreement (if she had no other Class 14 assets on hand at the end of the taxation year of disposition). Subsection 14(1) would apply to the eligible capital amount received by Ms. Mubarak.*

The $120,000 cost of the new agreement to Mr. Grando, paid to the franchisor, could be written off by Mr. Grando over its 12-year term.

If Ms. Mubarak and Mr. Grando jointly elect under subsection 13(4.2), no part of the proceeds of disposition for the former property will be an eligible capital amount or an eligible capital expenditure. The results are the same as in Example 1, except that Mr. Grando will now have two Class 14 properties:

- *the new franchise agreement, the $120,000 cost of which may be written off by him over its 12-year term; and*
- *the former property, deemed to have been acquired by him and included in aseparate class, the $85,000 cost of which may be written off by him over its deemed 20-year term.*

Example 3

Consider again Example 1, but suppose that the replacement franchise, purchased by Ms. Mubarak from Ms. Vincent, is itself the subject of a joint election by them under subsection 13(4.2). Ms. Mubarak is required to amortize her $30,000 UCC (see Example 1) over the original 20-year term of Ms. Vincent, not over its remaining 15 years.

Clause 7

Eligible Capital Property

ITA
14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties and operates on a pooling basis. Annual deductions, which are calculated as a percentage of this pool, may be claimed under paragraph 20(1)(*b*) of the Act. "Eligible capital property" includes goodwill, customer lists, farm quotas and licenses of unlimited duration.

Election re Capital Gain

ITA
14(1.01)

Subsection 14(1.01) of the Act permits a taxpayer to elect, in the taxpayer's return of income for a taxation year, to report a capital gain on the disposition of an eligible capital property in respect of which the taxpayer can identify the cost of the particular property. Where the taxpayer has so elected, the taxpayer is deemed to have disposed of a capital property with an adjusted cost base equal to that cost, for proceeds of disposition equal to the actual proceeds of the eligible capital property. Paragraph 14(1.01)(*a*) removes the property from the cumulative eligible capital pool by coincidentally deeming the proceeds of disposition of the eligible capital property to be equal to its original cost.

Subsection 14(1.01) is amended to clarify that it is the eligible capital expenditure by the taxpayer to acquire the eligible capital property that must be verifiable.

The amendments generally apply to dispositions of eligible capital property that occur after Announcement Date.

Acquisition of Eligible Capital Property

ITA
14(3)

Subsection 14(3) of the Act provides rules regarding non-arm's length transfers of eligible capital property. The provision prevents the deduction, under paragraph 20(1)(*b*) of the Act, of the portion of the purchaser's cost that is reflected in a capital gains exemption claimed by the vendor under section 110.6 of the Act. Absent any claim by the vendor of a capital gains exemption under subsection 110.6, the eligible capital expenditure to the purchaser generally equals the proceeds of disposition of the vendor. That is, the eligible capital expenditure of the purchaser equals 4/3 of the amount determined for the vendor under the description of E in the formula for the definition "cumulative eligible capital" in subsection 14(5) of the Act.

Paragraph 14(3)(*a*) is amended, for taxation years that end after February 27, 2000, to ensure that, if the eligible capital property is the subject of an election by the vendor under subsection 14(1.01) of the Act, the eligible capital expenditure of the purchaser will, subject to the adjustments in subsection 14(3) for deductions under section 110.6, equal the actual proceeds of disposition to the vendor.

Definition of Cumulative Eligible Capital

ITA
14(5)

The definition "cumulative eligible capital" provides for the calculation of a taxpayer's cumulative eligible capital property pool for the purpose of determining the taxpayer's allowable deduction in respect of eligible capital property (ECP) for the year.

Variable A in the definition "cumulative eligible capital" represents ¾ of the eligible capital expenditures of a taxpayer as the result of the acquisition of an eligible capital property after the taxpayer's "adjustment time" (generally since 1987). Variable A is amended to ensure that the taxpayer's pool does not include any portion of the non-taxable portion of a gain of a non-arm's length transferor that has been realized upon the transfer of an eligible capital property to the taxpayer after Announcement Date. Variable A is generally reduced by 1/2 of the gain of the transferor in respect of the property under paragraph 14(1)(*b*) or 38(*a*) of the Act. (Where the transferor has claimed a capital gains exemption in respect of the transfer under subsection 110.6 of the Act, subsection 14(3) reduces the taxpayer's eligible capital expenditure accordingly. The reduction in Variable A will therefore not include 1/2 of the amount of that claim.) Where the transferor has realized such a gain in a taxation year in respect of more than one property, the amount of the gain of the transferor for the purposes of this calculation is that proportion of the gain that the proceeds of disposition of the eligible capital property acquired by the taxpayer is of the total proceeds of disposition of all such property disposed of in the transferor's taxation year.

The reduction to Variable A does not apply where the eligible capital property has previously been disposed of by the taxpayer or was acquired on or before Announcement Date.

Example 1

Mr. X purchased a farm production quota several years ago for $300,000 and claimed no cumulative eligible capital amounts, such that his cumulative eligible capital at the end of his previous taxation year was $225,000. This year he sold the production quota to his sister, Mrs. Y, for its fair market value of $1,200,000. Mr. X reported income of $450,000 under paragraph 14(1)(b) of the Act, and did not claim a capital gains exemption under section 110.6 of the Act. (Alternatively, Mr. X could have made an election under subsection 14(1.01) of the Act to report a taxable capital gain under paragraph 38(a) of the Act.)

Because Mrs. Y purchased the production quota in a non-arm's length transaction, the amount included in Variable A of her cumulative eligible capital balance at the end of the year of acquisition would be $675,000 (i.e. 3/4 of $1,200,000, less 1/2 of the taxable gain of Mr. X of $450,000).

Example 2

Assume the same facts as Example 1, except that Mr. X claimed a capital gains exemption of $250,000 in respect of his $450,000 taxable gain under paragraph 14(1)(b) of the Act.

Mrs. Y's eligible capital expenditure under subsection 14(3) of the Act is deemed to be $700,000, calculated as 4/3 of the excess of

- *3/4 of the actual proceeds of disposition of $1,200,000 (i.e. $900,000)*

over

- *3/2 of the $250,000 capital gains exemption of Mr. X (i.e. $375,000)*

The amount included in Variable A of Mrs. Y's cumulative eligible capital balance is calculated as follows:

• *3/4 of her deemed eligible capital expenditure of $700,000*		*$525,000*
less 1/2 of the amount by which		
• *the taxable gain of Mr. X*	*$450,000*	
exceeds		
• *the capital gains exemption claimed by Mr. X*	*250,000*	
	200,000	
	x 1/2	
		100,000
Amount included in Variable A		*$425,000*

The calculation of "cumulative eligible capital" is designed so that the pool cannot be negative immediately after the end of the year. In this regard, variable F in the calculation generally reduces the pool by the total amount of ECP deductions claimed in prior years (generally, variable P), net of amounts included in income in prior years (variable R) under subsection 14(1) of the Act as recapture of ECP deductions or as deemed capital gains.

Variable R in the definition "cumulative eligible capital" is amended to ensure that amounts included in the income of a corporation under former paragraph 14(1)(*b*) of the Act (as it applied to taxation years that ended before February 28, 2000) continue to be included in the calculation of variable F.

The amendments apply to taxation years that end after February 27, 2000.

Exchange of Property

ITA
14(6)

Where a taxpayer has disposed of an eligible capital property in a taxation year and has acquired a replacement eligible capital property before the end of the subsequent taxation year, subsection 14(6) of the Act allows the taxpayer to elect to defer the inclusion of an amount in income under subsection 14(1) of the Act that would normally result from a negative balance in the taxpayer's cumulative eligible capital account at the end of the year of disposition.

Subsection 14(6) is amended to accommodate taxation years that are shorter than 12 months, by providing that the period for acquiring a replacement property ends at the later of the end of the subsequent taxation year and the time that is 12 months after the end of the taxation year in which the property was disposed of. This amendment applies in respect of dispositions of eligible capital property that occur in taxation years that end on or after the day that is 12 months before Announcement Date.

Clause 8

Shareholder Benefits

ITA
15

Section 15 of the Act requires the inclusion in income of certain benefits received or enjoyed by shareholder of a corporation.

Forgiven Amount

ITA
15(1.21)

Subsection 15(1.2) of the Act provides that, for the purpose of subsection 15(1), the value of the benefit where an obligation issued by a debtor is settled or extinguished is deemed to be the forgiven amount in respect of the obligation. Subsection 15(1.21) of the Act provides that, for the purpose of subsection 15(1.2), the expression "forgiven amount" in respect of an obligation has the meaning that would be assigned by subsection 80(1) of the Act if certain assumptions were made.

Subsection 15(1.21) of the French version of the Act refers to conditions that must be met in order for the provision to apply. This statement could be interpreted as requiring that the obligation referred to in the preamble of subsection 15(1.21) be a commercial obligation. In order to avoid this interpretation, the French version of subsection 15(1.21) is amended to clarify that the statements made in paragraphs 15(1.21)(*a*) to (*d*) are assumptions and not conditions.

This amendment applies to taxation years that end after February 21, 1994.

Shareholder Debt

ITA
15(2)

Subsection 15(2) of the Act requires that certain shareholder indebtedness be included in computing the income of the debtor. Included in such indebtedness are loans from a corporation to its shareholders, loans to persons connected with the shareholders, as well as loans from a partnership to a shareholder of one of its corporate members.

Subsection 15(2) was amended in 1998 by S.C. 1998, c.19, s.75(1) [formerly Bill C-28], generally applicable to loans and indebtedness arising in the 1990 and subsequent taxation years. Prior to that amendment, the English and French versions of subsection 15(2) referred to the expression "has become indebted" (devient la débitrice). However, the 1998 amendments incorrectly introduced into the French version of the subsection the expression « contracter une dette » (to incur a debt). This unintended inconsistency in terminology is corrected in the French version by replacing the expression « contracter une dette » (to incur a debt) with the expression « devient la débitrice » (has become indebted).

This amendment applies to loans made and indebtedness arising in the 1990 and subsequent taxation years.

Clause 9

Amount Owing by Non-resident

ITA
17

Section 17 of the Act provides rules dealing with the situation where a non-resident person owes an amount to a corporation resident in Canada. Subsection 17(1) generally applies where such an amount has remained outstanding for more than one year without the corporation including interest on that amount, computed at a reasonable rate, in computing its income. Where subsection 17(1) applies, it treats the Canadian resident corporation as having received interest on that amount, computed at a prescribed rate, at the end of each taxation year of the corporation during which that amount was outstanding.

ITA
17(8.1) and (8.2)

Subsection 17(8) of the Act provides an exception to subsection 17(1) with respect to amounts owing by a non-resident person to a particular corporation resident in Canada where

- the non-resident person is a controlled foreign affiliate of the particular corporation, and
- the amount owing meets the test set out in either subparagraph 17(8)(*a*)(i) or (ii).

However, the exception afforded by subsection 17(8) is not available in circumstances where the amount owing by the controlled foreign affiliate is incurred to pay existing indebtedness of the affiliate to another person or partnership (other than the particular corporation) because the amount owing arose for the purpose of allowing the affiliate to pay the existing indebtedness rather than for a use that qualifies under subparagraph 17(8)(*a*)(i) or (ii). New subsections 17(8.1) and (8.2) are introduced to address this issue.

New subsection 17(8.1) provides that new subsection 17(8.2) applies in respect of money (referred to as "new borrowings") that a controlled foreign affiliate of a particular corporation resident in Canada has borrowed from the particular corporation where the affiliate has used the new borrowings

- to repay money (referred to as "previous borrowings") previously borrowed from any person or partnership, if
  - the previous borrowings became owing after the last time that the affiliate became a controlled foreign affiliate of the particular corporation, and
  - the previous borrowings have, at all times after they became owing, been used for a purpose described in subparagraph 17(8)(*a*)(i) or (ii), or
- to pay an amount owing (referred to as the "unpaid purchase price") by the affiliate for property previously acquired from any person or partnership, if
  - the property was purchased, and the unpaid purchase price became payable, by the affiliate after the last time that the affiliate became a controlled foreign affiliate of the particular corporation, or
  - the unpaid purchase price is in respect of property that, at all times after the unpaid purchase price became payable by the affiliate, was property that had been used principally to earn income described in clause 17(8)(*a*)(i)(A) or (B).

New subsection 17(8.2) provides that the new borrowings are, for the purpose of subsection 17(8), deemed to have been used for the purpose for which the proceeds from the previous borrowings were used or were deemed by subsection 17(8.2) to have been used, or to acquire the property in respect of which the unpaid purchase price was payable, as the case may be.

New subsections 17(8.1) and (8.2) apply to taxation years that begin after February 23, 1998.

Clause 10

Prohibited Deductions

ITA
18

Section 18 of the Act prohibits the deduction of certain outlays and expenses in computing a taxpayer's income from a business or property.

Royalties, etc.

ITA
18(1)(*m*)

Paragraph 18(1)(*m*) of the Act prohibits a taxpayer from deducting an amount that is paid or payable in the year as a Crown royalty or similar amount in relation to the acquisition, development or ownership of a Canadian resource property or the production in Canada of, among other things, petroleum, natural gas or minerals. Paragraph 18(1)(*m*) is amended to remove the requirement that the obligation under which an amount described in that paragraph is collected be imposed by statute or a contractual obligation substituted for an obligation imposed by statute. This amendment, which applies to amounts that are paid or become payable after Announcement Date, eliminates any interpretive difficulties that may be associated with the phrase "contractual obligation substituted for an obligation imposed by statute". Exemptions will continue to be prescribed by section 1211 of the Regulations for amounts described in paragraph 18(1)(*m*) for which it would be inappropriate to deny a deduction.

Losses – Adventurers in Trade

ITA
18(14)

Subsection 18(14) of the Act describes the circumstances in which the loss-deferral rule in subsection 18(15) applies to dispositions of property that is described in an inventory of a business that is an adventure or concern in the nature of trade. Paragraph 18(14)(*c*) excludes from the application of the rule dispositions under specified provisions of the Act. As a consequence of the restructuring of section 132.2 of the Act, the reference in paragraph 18(14)(*c*) to paragraph 132.2(1)(*f*) is replaced by references to paragraphs 132.2(3)(*a*) and (*c*).

This amendment applies to dispositions that occur after 1998.

Clause 11

Non-application of Section 18.1

ITA
18.1(15), (16) and (17)

Section 18.1 of the Act provides rules that restrict the deductibility of a taxpayer's cost of a "right to receive production", by prorating the deductibility of the amount of the investment over the economic life of the right. In the transactions that are subject to these rules, investors undertake to pay expenditures that would otherwise be expenses payable by the "vendor" (e.g., payroll, selling commissions) in exchange for a right to receive future income (a "right to receive production"), usually from the vendor's business operations. Such an expenditure by the taxpayer, referred to as a "matchable expenditure", is defined in subsection 18.1(1) of the Act.

Subsection 18.1(15) of the Act provides two general exceptions to the application of the matchable expenditure rules. One such exception, in paragraph 18.1(15)(*b*), generally applies where the matchable expenditure relates to the issuance of an insurance policy for which all or a portion of a risk has been ceded to the taxpayer. This exception remains unchanged other than changes in numbering.

Paragraph 18.1(15)(*a*) provides the other exception to the matchable expenditure rules, applicable only if no part of the expenditure of the taxpayer can reasonably considered to have been paid to another person to acquire the right to receive production from that person. If this condition is met, the expenditures must meet one of two further criteria. Subparagraph 18.1(15)(*a*)(i) allows the exception if the taxpayer's expenditure cannot reasonably be considered to relate to a tax shelter investment and none of the main purposes of making the expenditure is to obtain a tax benefit. Alternatively, subparagraph

18.1(15)(*a*)(ii) allows the exception if, in the same year as the matchable expenditure is made, the total revenues of the taxpayer from the right to receive production exceed 80% of the expenditure. If this 80% revenue threshold is met, the portion of the expenditure that is deductible is limited only by general rules that apply to all business expenditures.

Subparagraph 18.1(15)(*a*)(i) is renumbered as new subsection 18.1(16) and remains unchanged. The alternative exception in subparagraph 18.1(15)(*a*)(ii) (the 80% revenue threshold) is renumbered as new subsection 18.1(17) and no longer provides a general exception to the application of the matchable expenditure rules. This amended rule provides that if any portion of the matchable expenditure can reasonably be considered to relate to a tax shelter or a tax shelter investment, subsection 18.1(4), which requires the amortization of the expenditure (subject to an income limit), will apply without reference to paragraph 18.1(4)(*a*). The result is that the cumulative amount deducted in respect of a matchable expenditure may not exceed the taxpayer's cumulative revenue from the associated right to receive production.

The amendments to section 18.1 generally apply in respect of expenditures made by a taxpayer on or after September 18, 2001.

Clause 12

Deductions

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from business or property.

Reserve not Available

ITA
20(8)

Paragraph 20(1)(*n*) of the Act allows a taxpayer to claim a reserve in respect of the taxpayer's profit from the sale of certain property, where all or part of the proceeds of the sale are not due until at least two years after the time of sale. However, subsection 20(8) of the Act provides that this reserve is limited to taxation years that end less than 36 months after the time of the sale. For example, where the taxation year is 12 months, the reserve is available in the taxation year in which the sale occurred and the two subsequent taxation years.

New paragraphs 20(8)(*c*) and (*d*) apply, in respect of dispositions of property that occur after Announcement Date, to provide that the reserve under paragraph 20(1)(*n*) is not available to a taxpayer where the purchaser of the property is a corporation controlled by the taxpayer or is a partnership of which the taxpayer is a majority interest partner.

Deduction for Foreign Tax

ITA
20(12)

Subsection 20(12) of the Act allows a taxpayer to deduct, in computing income for a taxation year from a business or property, non-business income taxes paid to a foreign government in respect of the income. The subsection is amended to make explicit the requirement that the taxpayer claiming the deduction be resident in Canada during all or part of the year for which the claim is made. This amendment is clarifying only, and applicable after Announcement Date. (Accordingly, the amendment is effective for any application of the Act after that date.)

Terminal Loss

ITA
20(16)

Subsection 20(16) of the Act permits a taxpayer to deduct, in computing the taxpayer's income for a year, the terminal loss of the taxpayer in respect of a class of depreciable property at the end of the year. That subsection is amended to add a reference to new descriptions D.1 and K of the definition "undepreciated capital cost" in subsection 13(21) of the Act. For information about those new descriptions, see the commentary to subsection 13(1).

This amendment applies to taxation years that end after February 23, 1998, and corrects a technical deficiency.

Non-Application of Subsection (16)

ITA
20(16.1)

Subsection 20(16.1) of the Act provides that a terminal loss under subsection 20(16) in respect of a depreciable property that is a "passenger vehicle" costing more than a prescribed amount (currently set at $30,000) is not deductible in computing income. That rule is renumbered as paragraph 20(16.1)(*a*) and new paragraph 20(16.1)(*b*) is added, applicable to taxation years that end after Announcement Date. These amendments are made concurrently with the addition of subsections 13(4.2) and (4.3) of the Act and with the amendment of the definition "former business property" in subsection 248(1) of the Act.

New paragraph 20(16.1)(*b*) provides that a terminal loss is not available in respect of another person's former business property that was deemed under paragraphs 13(4.3)(*a*) or (*b*) (as the result of a joint election under subsection 13(4.2) by the taxpayer and the other person) to be owned by the taxpayer. For further information, refer to the commentary to subsections 13(4.2) and (4.3).

Clause 13

Scientific Research and Experimental Development

ITA
37

Section 37 of the Act sets out the rules governing the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR&ED).

ITA
37(8)(*a*)(ii)(B)(V)

Paragraph 37(8)(*a*) provides rules for interpreting the expression "expenditures on or in respect of scientific research and experimental development" which is used in subsections 37(1), (2) and (5).

Clause 37(8)(*a*)(ii)(B) provides for the alternative "proxy" method for determining SR&ED expenditures. Subclause 37(8)(*a*)(ii)(B)(V) provides that, in the context of the proxy method for determining SR&ED expenditures, the references to expenditures on or in respect of SR&ED (other than in subsection 37(2)) include only, among things listed in clause (8)(*a*)(ii)(B), the cost of "materials consumed" in the prosecution of SR&ED in Canada.

Subclause 37(8)(*a*)(ii)(B)(V) is amended for costs incurred after February 23, 1998 in two respects. First, the phrase "materials consumed" is changed to "materials consumed or transformed". Second, the reference in the French version of the subclause to "matières" is changed to "matériaux".

Clause 14

Allocation of Gain on Gifts to Qualified Donees

ITA
38.1

Paragraphs 38(*a*.1) and (*a*.2) of the Act provide a special inclusion rate for capital gains arising as a result of a gift to qualified donees of certain securities or of environmentally sensitive land. This inclusion rate is one-half of the normal inclusion rate.

Section 38.1 of the Act is added consequential to the addition of new subsections 248(30) to (33) of the Act, for gifts made after Announcement Date. New section 38.1 provides that, where a taxpayer is entitled to an advantage or benefit in respect of a gift, only part of the taxpayer's capital gain will be entitled to the special inclusion rate. The part entitled to the special inclusion rate is that proportion of the gain that the eligible amount of the gift is of the taxpayer's total proceeds of disposition in respect of the property.

For additional details, see the commentary to new subsections 248(30) and (31) regarding the eligible amount of a gift and the amount of the advantage in respect of a gift.

Clause 15

Gains and Losses – General Rules

ITA
40

Section 40 of the Act provides rules for determining a taxpayer's gain or loss from the disposition of a property.

Gift of Non-qualifying Security

ITA
40(1.01)(*c*)

Subsection 40(1.01) of the Act allows a taxpayer to claim a reserve in respect of any gain realized from the making of a gift of a "non-qualifying security", as defined for the purposes of sections 110.1 and 118.1 of the Act. The gift is not recognized as a gift for the purposes of those sections until a subsequent time when the security ceases to be a non-qualifying security or it is disposed of by the donee. The reserve available in subsection 40(1.01) allows the resulting inclusion in income to be deferred until the year that includes the subsequent time, unless the taxpayer first becomes non-resident or tax-exempt.

Paragraph 40(1.01)(*c*) is amended consequential to the addition of new subsections 248(30) to (33) of the Act, for gifts made after Announcement Date, to provide that the reserve claimed by the taxpayer may not exceed the eligible amount of the gift. For additional details, see the commentary to subsection 248(30) of the Act regarding the eligible amount of a gift.

Reserve on Property Sold to a Controlled Partnership

ITA
40(2)(*a*)

Paragraph 40(2)(*a*) of the Act generally restricts a taxpayer's ability to claim a capital gains reserve in respect of properties disposed of to a non-resident or to a corporation that controlled the taxpayer or was controlled by the taxpayer. Paragraph 40(2)(*a*) is amended in respect of dispositions of property that occur after Announcement Date, to provide that a capital gains reserve will also not be allowed to a taxpayer where the purchaser of the property is a partnership of which the taxpayer is a majority interest partner.

Limited Partner

ITA
40(3.14)(*a*)

Subsection 40(3.1) of the Act provides that a member of a partnership is considered to realize a capital gain from the disposition, at the end of a fiscal period of the partnership, of the member's interest in the partnership where, at the end of the fiscal period, the member is a limited partner or was, since becoming a partner, a "specified member" of the partnership and the member's adjusted cost base of the interest is negative at that time.

Subsection 40(3.14) of the Act provides an extended definition of "limited partner" for the purpose of determining whether a member's interest in a partnership is subject to the negative adjusted cost base rule in subsection 40(3.1).

Paragraph 40(3.14)(*a*) provides that a member of a partnership is a "limited partner" if, by operation of law governing the partnership agreement, the liability of the member as a member is limited.

However, paragraph 40(3.14)(*a*) does not apply in cases where a member's liability is limited by operation of a statutory provision of Canada (or of a province) that limits the member's liability only for the debts, obligations and liabilities of a limited liability partnership (or of any member of the partnership) arising from negligent acts or omissions of another member of the partnership (or of an employee, agent or representative of the partnership) in the course of the partnership business and while the partnership is a limited liability partnership.

The Province of Quebec has amended its legislation concerning partnerships to allow partners to carry on their activities within a limited liability partnership. That legislation refers to the civil law concept of "fault/fautes". Paragraph 40(3.14)(*a*) of the English version does not currently refer to the civil law concept of "fault" and is amended to do so, effective after June 20, 2001.

Deemed Identical Property

ITA
40(3.5)

Subsections 40(3.3) and (3.4) of the Act set out rules under which losses on certain dispositions of non-depreciable capital property are deferred. In some cases, the application of these rules is contingent upon whether one property is identical to the disposed of non-depreciable capital property.

Current paragraph 40(3.5)(*b*) treats a share that is acquired in exchange for another share under any of a number of sections as being identical to that other share. Among the effects of this deeming rule is to ensure that a deferred loss is not inappropriately realized through a transaction under one of those sections.

For example, assume that a taxpayer who on Day 1 disposed of a share for proceeds that were less than the taxpayer's adjusted cost base of the share reacquired an identical share on Day 15. Under the loss-deferral rules, the taxpayer's loss on the disposition will be deferred until, generally, neither the taxpayer nor an affiliated person owns such a share. If the taxpayer then exchanged that share for another, under for example an exchange under section 86 of the Act, it would be appropriate to continue to defer recognition of the deferred loss until that substituted share is disposed of. This is accomplished by treating the share acquired on the exchange as identical to the share given up.

However, paragraph 40(3.5)(*b*) can have an inappropriate effect where a taxpayer uses the share-for-share exchange rule in section 85.1 of the Act. Provided certain criteria are satisfied, that section permits a share-for-share exchange to take place on a tax-deferred basis, but it also allows the exchanging shareholder to realize a loss. A shareholder who chooses to do so may find that paragraph 40(3.5)(*b*) forces a deferral of that loss – even though the loss arises from the section 85.1 exchange itself, not from a previous disposition as in the above example.

Paragraph 40(3.5)(*b*) is amended to deem a share that is acquired in exchange for another share under section 85.1 to be identical to that other share only if the loss in respect of the exchanged share is suspended at the time of the exchange by virtue of subsections 40(3.3) and (3.4).

This amendment to paragraph 40(3.5)(*b*) applies to dispositions of property that occur after April 26, 1995, subject to the coming-into-force provisions that originally enacted subsection 40(3.5).

Clause 16

Part Dispositions

ITA
43

Section 43 of the Act provides rules governing the disposition of part of a property. For the purpose of computing a taxpayer's gain or loss from the disposition of a part of a property, a portion of the adjusted cost base must be allocated to the part on a reasonable basis.

Ecological Gifts

ITA
43(2)

Section 43(2) of the Act applies where the part of a property donated as an ecological gift is a covenant, easement or servitude established under common law, the civil law of the province of Quebec, or the law of other provinces allowing for their establishment. Subsection 43(2) ensures that a portion of the adjusted cost base ("ACB") of the land to which the covenant, easement or servitude relates is allocated to the donated covenant, easement or servitude. For this purpose, the allocation of the ACB of the land to the gift is calculated in proportion to the percentage decrease in the value of the land as a result of the donation.

Subsection 43(2) is amended to clarify its application to "real servitudes" under the *Civil Code of Quebec*. This amendment applies to gifts made after Announcement Date.

Clause 17

Life Estates in Real Property

ITA
43.1(1)

Section 43.1 of the Act deals with the disposition of a remainder interest in real property by a taxpayer who retains the life estate or estate *pur autre vie* in the property. Subsection 43.1(1) provides that in such a case the taxpayer will be considered to have disposed of the life estate, that has been retained, for proceeds equal to its fair market value at the time the remainder interest is disposed of, and to have reacquired the life estate immediately after that time at the same fair market value.

However, subsection 43.1(1) does not apply in cases where the remainder interest is a gift to a donee described in the definition "total charitable gifts" or "total Crown gifts" in subsection 118.1(1) of the Act. Subsection 43.1(1) is amended to also preclude its application to gifts made to donees described in the definition "total ecological gifts" in subsection 118.1(1). This amendment applies to dispositions of life interests that occur after February 27, 1995, when ecological gifts were first defined for the purposes of section 118.1.

Clause 18

Exchanges of Property

ITA
44(1)(*c*) and (*d*)

Subsection 44(1) of the Act allows a taxpayer who incurs a capital gain on the disposition of certain capital property to elect to defer tax on the gain to the extent that the taxpayer reinvests the proceeds in a replacement property within a certain period of time, namely

- in the case of certain involuntary dispositions, e.g., theft or expropriation, before the end of the second taxation year of the taxpayer that begins after the property was disposed of, or

- in other situations, before the end of the first taxation year of the taxpayer that begins after the property was disposed of.

Paragraphs 44(1)(*c*) and (*d*) are amended to accommodate taxation years that are shorter than 12 months, by providing that the periods for acquiring replacement property end at the later of the times mentioned above and

- in the case of involuntary dispositions, within 24 months after the end of the taxation year in which the property was disposed of, or

- in other situations, within 12 months after the end of the taxation year in which the property was disposed of.

These amendments apply, in the case of involuntary dispositions, in respect of dispositions that occur in taxation years that end on or after the day that is 24 months before Announcement Date and, in any other case, in respect of dispositions that occur in taxation years that end on or after the day that is 12 months before Announcemnt date.

Where Subparagraph (1)(*e*)(iii) Does not Apply

ITA
44(7)

Subsection 44(7) of the Act restricts a taxpayer from claiming a capital gains reserve under subparagraph 44(1)(*e*)(iii) where the former property of the taxpayer was disposed of to a non-resident or a corporation that, immediately after the disposition, controlled the taxpayer or was controlled by the taxpayer or by a person or group of persons who controlled the taxpayer. Subsection 44(7) is amended, in respect of dispositions of property that occur after Announcement Date, to provide that the capital gains reserve is also not allowed to a taxpayer where the purchaser of the property is a partnership of which the taxpayer is a majority interest partner.

Clause 19

Capital Gains Deferral – Eligible Small Business Investments

ITA
44.1

Section 44.1 of the Act permits an individual to defer, in certain circumstances, the recognition for income tax purposes of all or a portion of a capital gain arising on a disposition of an eligible small business investment.

Special Rule – Eligible Small Business Corporation Share Exchanges

ITA
44.1(6)

Subsection 44.1(6) of the Act provides rules that apply where an individual exchanges an eligible small business corporation share for new eligible small business corporation share. Subsection 44.1(6) is amended to substitute the reference to subsection 85.1(3) with a reference to paragraph 85.1(1)(*a*) and to add a reference to sections 51 and 86. These changes apply to dispositions of shares made after February 27, 2000.

Special Rule – Active Business Corporation Share Exchanges

ITA
44.1(7)

Subsection 44.1(7) of the Act provides rules that apply where an individual, in the course of a qualifying disposition, disposes of common shares of an active business corporation for consideration consisting only of new common shares of another active business corporation issued to the individual. Subsection 44.1(7) is amended to substitute the reference to subsection 85.1(3) with a reference to paragraph 85.1(1)(*a*) and to add a reference to sections 51 and 86.

These changes apply to dispositions of shares made after February 27, 2000.

Order of Disposition of Shares

ITA
44.1(13)

New subsection 44.1(13) of the Act is a provision that applies when an individual disposes of a share that is identical to other shares owned by the individual. The provision deems, for the purposes of section 44.1, the shares to have been disposed of in the same order in which the individual acquired them.

New subsection 44.1(13) applies to dispositions that occur after Announcement Date or, if the individual so elects in writing and files the election with the Minister of National Revenue, to dispositions made after February 27, 2000.

Clause 20

Deductions from Adjusted Cost Base – Interest in a Partnership

ITA
53(2)(*c*)(iii)

Paragraph 53(2)(*c*) of the Act provides deductions from a taxpayer's adjusted cost base ("ACB") of a partnership interest for the purpose of determining its adjusted cost base. Subparagraph 53(2)(*c*)(iii) provides for the deduction from the ACB of a partnership interest of an amount deemed by subsection 110.1(4), 118.1(8) or 127(4.2) of the Act to have been a charitable donation or a political party contribution because of the taxpayer's membership in the partnership.

Subparagraph 53(2)(*c*)(iii) is amended, consequential to the amendment of subsections 110.1(4), 118.1(8) and 127(4.2) and the addition of new subsection 248(30) of the Act, for gifts made after Announcement Date. Amended subparagraph 53(2)(*c*)(iii) refers to the "eligible amount" of a gift or contribution made because of the taxpayer's membership in the partnership. For additional information about eligible amounts, see the commentary to new subsections 248(30) and (31).

Clause 21

Definitions – Capital Gains and Losses

ITA
54

"superficial loss"

Section 54 of the Act defines various terms for the purposes of the rules relating to taxable capital gains and allowable capital losses. The definition "superficial loss" in section 54 excludes losses on dispositions listed in paragraphs (*c*) to (*h*) of the definition from being superficial losses. As a consequence of the restructuring of section 132.2 of the Act, the reference in paragraph (*c*) of the definition to paragraph 132.2(1)(*f*) is replaced by references to paragraphs 132.2(3)(*a*) and (*c*).

This amendment applies to dispositions that occur after 1998.

Clause 22

Exception to Principal Residence Rules

ITA
54.1(1)

Section 54.1 of the Act sets out an exception to the principal residence rules. Under the rules in section 54 of the Act, if a housing unit is not ordinarily inhabited in a year and is rented out, it can continue to qualify as a principal residence for up to 4 years if the taxpayer so elects under subsection 45(2) of the Act. However, under section 54.1 it can continue to so qualify indefinitely provided that, as a consequence of a relocation of employment of the taxpayer or the taxpayer's spouse or common-law partner, the property is not ordinarily inhabited by the taxpayer. The recent amendments to add references in the Act to a common-law partner was not made to the English version of section 54.1. The current amendment adds the required reference and corrects that oversight and generally applies to the 2001 and subsequent taxation years. However, it may apply as early as 1998 where common-law partners have jointly elected to be treated as such under the Act, starting in that year.

Clause 23

Tax Avoidance – Dividends

ITA
55

Section 55 of the Act deals with certain tax avoidance transactions.

Definitions

ITA
55(1)

Subsection 55(1) of the Act sets out a number of definitions for the purpose of section 55.

"qualified person"

The definition "qualified person" is added to subsection 55(1), in conjunction with amendments to clause 55(3.1)(*b*)(i)(B) and paragraph 55(3.2)(*h*) of the Act. As a result of these amendments, a person or partnership may exchange shares of a distributing corporation ("old shares") for new shares of the distributing corporation and, where the conditions set out in the definition are satisfied, the ownership of the old shares will not affect the tax treatment of dividends received in the course of a reorganization to which paragraph 55(3)(*b*) applies. In general terms, a qualified person is a person or partnership that exchanges all of the old shares that caused that person or partnership to be a specified shareholder of the distributing corporation for consideration consisting solely of shares of a specified class. The definition also provides that the old shares must not be shares of a specified class solely because they were convertible into a class of shares that was not a specified class and that every holder of old shares must participate in the exchange. In addition, a person or partnership will not be a qualified person unless the old shares and the new shares are non-voting in respect of the election of the board of directors (or have voting rights only in the event of failure or default under the terms of the shares).

The addition of the definition "qualified person", applicable in respect of dividends received after 1999, is made concurrently with the addition of new subsection 55(3.4) of the Act. New subsection 55(3.4) provides that shares of a specified class are not taken into consideration in determining if a person is a specified shareholder for the purpose of subparagraph 55(3.1)(*b*)(i) and for the purpose of paragraph 55(3.2)(*h*), as that paragraph applies for the purpose of subparagraph 55(3.1)(*b*)(iii).

"specified class"

The definition "specified class" is relevant in determining whether an exchange of shares of the capital stock of a distributing corporation for shares of the capital stock of another corporation constitutes a permitted exchange, which, in turn, is relevant for the purpose of paragraph 55(3.1)(*b*) of the Act. The definition "specified class" is also relevant in determining if a redemption of shares by the distributing corporation prior to a distribution is a permitted redemption.

The rules applicable to shares of a specified class are based on the premise that such shares are equivalent to debt. Thus, to ensure that these shares more closely resemble debt, the definition is amended, for shares issued after Announcement Date, to include a requirement that they be non-voting with respect to the election of the directors of the corporation (or have voting rights only in the event of failure or default under the terms of the shares).

Exempt Dividends

ITA
55(3)(*a*)

Paragraph 55(3)(a) provides an exemption from the application of subsection 55(2) of the Act for dividends received in the course of certain related-party transactions. More specifically, paragraph 55(3)(*a*) exempts a dividend received by a corporation if, as part of a transaction or event or a series of transactions or events that includes the receipt of the dividend, there was not, at any particular time, a disposition of property or a significant increase in the total direct interest in a corporation in the circumstances described in subparagraphs 55(3)(*a*)(i) to (v).

ITA
55(3)(*a*)(iii)(B)

Clause 55(3)(a)(iii)(B) of the Act describes a disposition, to a person or partnership that was unrelated to the dividend recipient, of property more than 10% of the fair market value of which was derived from shares of the capital stock of the dividend payer. Clause 55(3)(*a*)(iii)(B) is amended, for dividends received after February 21, 1994, to exclude a disposition of property that is a share of the capital stock of the dividend recipient. This amendment ensures that subsection 55(2) of the Act does not apply to the dividend received in the circumstances described in the following example:

> *A corporation (BuyerCo) owns all the share of another corporation (SubCo). BuyerCo acquires all the shares of a third corporation ((Target) in an arm's length transaction for fair market value. Target owns all the shares of two corporations – T1Subco and T2Subco. Target transfers, on a tax-deferred basis under section 85, all the shares of T2SubCo to SubCo in consideration for*

High/Low Shares of SubCo. SubCo subsequently redeems the High/Low Shares with the result that Target receives a deemed dividend. Target sells the shares of T1SubCo to a third party for proceeds of disposition equal to fair market value at the time of the disposition.

Interpretation for Paragraph 55(3)(*a*)

ITA
55(3.01)(*d*)

Paragraphs 55(3.01)(*a*) to (*e*) of the Act contain various interpretive rules for the purpose of paragraph 55(3)(*a*) of the Act. Paragraph 55(3.01)(*d*) provides that proceeds of disposition are to be determined without reference to the application of paragraph 55(2)(*a*) of the Act. This rule is intended to ensure that proceeds of disposition do not include a dividend or deemed dividend that is subject to subsection 55(2).

Section 93 of the Act permits a corporation resident in Canada to elect to treat the proceeds of disposition of a share of a foreign affiliate as a dividend in certain circumstances. Where such an election is made, the proceeds of disposition of the share are reduced accordingly. The reduction in the proceeds of disposition under section 93 is not intended to affect the application of paragraph 55(3)(*a*). Thus, paragraph 55(3.01)(*d*) is amended, for dividends received after February 21, 1994, to ensure that, for the purpose of paragraph 55(3)(*a*), proceeds of disposition are determined without reference to section 93.

Where Paragraph (3)(*b*) not Applicable

ITA
55(3.1)(*b*)(i)(B)

Paragraph 55(3.1)(*b*) of the Act provides that a dividend received in the course of a reorganization to which paragraph 55(3)(*b*) applies is not excluded from the application of subsection 55(2) of the Act if one of the transactions or events described in paragraph 55(3.1)(*b*) occurs as part of the series of transactions or events that includes the receipt of the dividend. Subparagraph 55(3.1)(*b*)(i) deals with a disposition of property in circumstances described in clauses

55(3.1)(*b*)(i)(A) to (C). Clause 55(3.1)(*b*)(i)(A) describes the type of property (i.e., shares of the distributing or transferee corporation or property whose value is derived from such shares), clause 55(3.1)(*b*)(i)(B) describes the type of vendor (i.e., a specified shareholder of the distributing or transferee corporation) and clause 55(3.1)(*b*)(i)(C) describes the type of acquirer (i.e., a person unrelated to the vendor or a partnership).

Clause 55(3.1)(*b*)(i)(B) is amended, for dividends received after 1999, to exclude a vendor that is a qualified person in relation to the distribution. "Qualified person" is a new expression defined in subsection 55(1) of the Act. For additional information, see the commentary to "qualified person" under subsection 55(1).

Interpretation

ITA
55(3.2)(*h*)

Subsection 55(3.2) of the Act sets out a number of interpretative rules for the purpose of paragraph 55(3.1)(*b*). Paragraph 55(3.2)(*h*) provides that each corporation that is a shareholder and specified shareholder of the distributing corporation at any time during the course of the series of transactions or events that includes a distribution is deemed to be a transferee corporation in relation to the distributing corporation. Paragraph 55(3.2)(*h*) is amended, for dividends received after 1999, to ensure that a "qualified person" as defined in subsection 55(1) is not deemed by this provision to be a transferee corporation in relation to the distributing corporation. For additional information, see the comments in the explanatory note to "qualified person" under subsection 55(1).

Specified Shareholder

ITA
55(3.4)

New subsection 55(3.4) of the Act is added to provide that shares of a specified class are not to be considered in determining whether a person is a specified shareholder for the purposes of subparagraph 55(3.1)(*b*)(i) and paragraph 55(3.2)(*h*) (as it applies for the purpose of subparagraph 55(3.1)(*b*)(iii)) and for the purpose of the definition "qualified person" in subsection 55(1) of the Act. New subsection 55(3.4), which applies to dividends received after 1999, ensures that a person or partnership that would not, but for the ownership of shares of a specified class, be a specified shareholder, will not be subject to the restrictions on the disposition of property described in subparagraph 55(3.1)(*b*)(i) and will not be deemed to be a transferee corporation for the purpose of subparagraph 55(3.1)(*b*)(iii).

Amalgamations – Related Corporations

ITA
55(3.5)

Subsection 55(3.5) of the Act is a new provision that applies for the purposes of paragraphs 55(3.1)(*c*) and (*d*) of the Act. Paragraphs 55(3.1)(*c*) and (*d*) provide that a dividend arising in the course of a reorganization to which paragraph 55(3)(*b*) applies is not exempt from the application of subsection 55(2) of the Act where, as part of the series of transactions or events that includes the receipt of the dividend, property described therein is acquired by a particular person or partnership. In the case of paragraph 55(3.1)(*c*), the particular person is a person who is not related to the transferee corporation (or ceases to be related to the transferee corporation). In the case of paragraph 55(3.1)(*d*), the particular person is a person who is not related to the distributing corporation (or ceases to be related to the distributing corporation). Property described in paragraph 55(3.1)(*c*) does not include a share of the capital stock of the transferee corporation. Similarly, property described in paragraph 55(3.1)(*d*) does not include a share of the capital stock of the distributing corporation.

New subsection 55(3.5), which applies to dividends received after April 26, 1995, deems an amalgamated corporation to be the same corporation as, and a continuation of, each of its predecessor corporations provided each of the predecessor corporations was related to each other immediately before the amalgamation. As a result, the references in paragraphs 55(3.1)(*c*) and (*d*) to a share of the capital stock of the transferee or distributing corporation include a share of the capital stock of a new corporation formed on an amalgamation where the new corporation is deemed by new subsection 55(3.5) to be the same corporation as, and a continuation of, the transferee or distributing corporation, as the case may be.

Unlisted Shares of Public Corporation Deemed to be Listed

ITA
55(6)

New subsection 55(6) of the Act, which applies to shares issued after April 26, 1995, treats a taxpayer's unlisted shares of a public corporation ("reorganization shares") – that were issued to the taxpayer and redeemed in the course of a tax-deferred reorganization spin-off by the public corporation – to be listed on a prescribed stock exchange. This subsection ensures that the shares are listed on a prescribed stock exchange for the purposes of the clearance certificate rule in subsection 116(1) and the definition "taxable Canadian property" in subsection 248(1) of the Act. However, for this treatment to apply, the following conditions must be met:

- A dividend must be received in the course of the reorganization to which the anti-avoidance rule in subsection 55(2) does not apply because of the exception for certain spin-off butterfly transactions in paragraph 55(3)(*b*);
- In contemplation of the reorganization
    - the reorganization share must be issued to a taxpayer by a public corporation in an exchange for another share of that corporation (the old share) owned by the taxpayer, and
    - the reorganization share must be exchanged by the taxpayer for a new share of another public corporation in an exchange that would be within the meaning of the definition "permitted exchange" in subsection 55(1) if that definition were read without reference to paragraph (*a*) and subparagraph (*b*)(ii) of that definition. In other words, the exchange occurs in contemplation of a public corporation transacting a spin-off reorganization;
- Immediately before the exchange, the old share
    - must be listed on a prescribed stock exchange, and
    - must not be taxable Canadian property of the taxpayer; and

- The new share must be listed on a prescribed stock exchange.

Clause 24

Foreign Retirement Arrangement

ITA
56(12)

Clause 56(1)(*a*)(i)(C.1) of the Act generally requires that payments received by a taxpayer from a foreign retirement arrangement (FRA) be included in computing the taxpayer's income as a superannuation or pension benefit. An FRA is defined in subsection 248(1) of the Act as a prescribed plan or arrangement. Presently, the only arrangements prescribed to be an FRA under Regulation 6803 are individual retirement accounts and annuities (IRAs) established pursuant to section 408(a), (b) or (h) of the United States' *Internal Revenue Code of 1986* (referred to as the "Code").

New subsection 56(12) is introduced to require Canadian residents who hold IRAs to include in income any amount treated under the Code as a distribution from an IRA, to the extent that the amount is required to be included in income for U.S. tax purposes. New subsection 56(12), among other things, gives effect to a proposal that was announced in Finance Canada News Release 1998-129, dated December 18, 1998.

In certain circumstances, the Code provides that an amount is to be treated as a distribution from an IRA even though no distribution has in fact been made. For example, if an individual converts an IRA into a Roth IRA (which is an individual retirement plan established pursuant to section 408A(b) of the Code) simply by amending the plan terms, section 408A(d)(3)(C) of the Code treats the converted amount as a distribution from the regular IRA and, thus, includible in income for U.S. tax purposes. For Canadian tax purposes, however, the converted amount might not be considered to have been received by the individual and, thus, could escape taxation in Canada. Other circumstances in which the Code treats a distribution to have occurred include borrowing money from an IRA and using an IRA as security for a loan. New subsection 56(12) clarifies that such "deemed" distributions under the Code are to be treated as distributions for Canadian income tax purposes.

More specifically, subsection 56(12) provides that, for the purpose of subsection 56(1)(*a*), an individual is deemed to have received an amount as a payment from an FRA where, as a result of a transaction, event or circumstance, the income tax laws of the foreign country in which the FRA is established treats the amount as having been distributed from the FRA to the individual. The taxation year in which the individual is deemed to have received the amount is the taxation year that includes the time of the transaction, event or circumstance.

Subsection 56(12) applies to the 1998 and subsequent taxation years except that, in its application to the 1998 to 2001 taxation years, two modifications are made. First, its application is limited to circumstances involving the conversion of an IRA into a Roth IRA. Second, for conversions of IRAs into Roth IRAs that occurred in 1998, the amount and timing of the income inclusion in Canada will match the amount and timing in the U.S. Under the Code, individuals who converted an IRA into a Roth IRA in 1998 were entitled to spread the income inclusion over a four-year period. Subsection 56(12) provides for the same treatment. However, if an individual became resident in Canada after having converted an IRA into a Roth IRA in 1998, the individual will not be subject to taxation in Canada on any amounts relating to the conversion that remain taxable for U.S. tax purposes.

Clause 25

Transfers of Refund of Premiums under RRSP

ITA
60(*l*)

Section 60 of the Act provides for various deductions in computing income.

When an individual who is a spouse, common-law partner or financially dependent child or grandchild of another person receives, on the death of that person, a distribution from a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) under which that person was the annuitant, the individual is required to include the amount in income. However, paragraph 60(*l*) of the Act provides an offsetting deduction if the amount is used within a specified period of time to acquire an annuity described in subparagraph 60(*l*)(ii). (Under certain circumstances, the amount may also be paid into an RRSP or RRIF.)

There are two basic types of annuity described in subparagraph 60(*l*)(ii). The first (described in clause 60(*l*)(ii)(A)) is a life annuity (or an annuity payable to age 90) under which the individual is the annuitant. Where the individual is a child or grandchild of the deceased RRSP or RRIF annuitant, a deduction for this type of annuity is available only if the child or grandchild was dependent on the deceased by reason of physical or mental infirmity. The second (described in clause 60(*l*)(ii)(B)) is an annuity payable for a fixed number of years not exceeding 18 minus the individual's age in years at the time the annuity is acquired. In this case, the annuitant can be either the individual or a trust under which the individual is the sole person beneficially interested in amounts payable under the annuity.

Clause 60(*l*)(ii)(A) is amended to allow (as is the case in clause 60(*l*)(ii)(B)) a trust to be named as the annuitant under the annuity. This option will be available if the individual is physically or mentally infirm and is the sole person beneficially interested in amounts payable under the annuity.

This amendment applies to taxation years that end after 2000.

Clause 26

Child Care Expenses

ITA
63(2)(*b*)

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing an individual's income. When more than one taxpayer contributes to the support of an eligible child, the child care expense deduction must generally be claimed by the taxpayer with the lower income for the year. One of the exceptions to this rule is where a medical doctor certifies that the lower-income supporting individual is incapable of caring for children because of that individual's mental or physical infirmity. This amendment clarifies that such a certification has to be in writing.

This amendment applies to certifications made after Announcement Date.

Clause 27

Exploration and Development Expenses

ITA
66

Section 66 of the Act provides rules in respect of Canadian and foreign exploration and development expenses.

Canadian Exploration Expenses to Flow-Through Shareholder

ITA
66(12.6)

Subsection 66(12.6) of the Act permits a principal-business corporation to renounce Canadian exploration expenses ("CEE") to its flow-through shareholders. To be eligible for flow-through treatment, CEE must be incurred in the 24-month period that begins on the day on which the relevant flow-through share agreement is entered into and must be incurred, or deemed to be incurred, on or before the effective date of the renunciation.

Subsection 66.1(9) of the Act provides for the reclassification of certain Canadian development expenses as CEE ("reclassified CDE"). The reclassified CDE is deemed, for the purposes of the Act, to be incurred by the taxpayer at the time of the reclassification and not at the time the reclassified CDE was actually incurred. To ensure that expenses actually incurred before a flow-through share agreement is entered into cannot be renounced under a flow-through share agreement, subsection 66(12.6) is amended, applicable to renunciations made after Announcement Date, to exclude reclassified

CDE from CEE that may be renounced by a corporation to its flow-through shareholders.

Effect of Renunciation

ITA
66(12.63)

Subsection 66(12.63) of the Act provides that Canadian development expenses renounced under subsection 66(12.62) of the Act by a corporation to a person are considered to have been incurred by that person on the effective date of the renunciation and not to have been incurred by the corporation. A partnership that incurs an expense as a consequence of a renunciation under subsection 66(12.62) is deemed by subsection 66(12.6901) of the Act not to have incurred the expense if specified filing requirements in subsection 66(12.69) of the Act are not satisfied.

Subsection 66(12.63) currently provides that it is subject to subsections 66(12.691) to (12.702) of the Act. Subsection 66(12.63) is amended, applicable to renunciations made after Announcement Date, to provide that it is subject to subsections 66(12.69) to (12.702).

Expenses in the First 60 Days of the Year

ITA
66(12.66)

Subsection 66(12.66) of the Act permits a corporation to renounce Canadian exploration expenses ("CEE") and Canadian development expenses ("CDE") to a flow-through shareholder within defined limits. Where the conditions described in subsection 66(12.66) are met, the corporation may renounce in January, February or March of a particular calendar year, effective as of the end of the preceding calendar year, the expenses described in subsection 66(12.66) that the corporation has incurred, or plans to incur, in the particular year. In other words, subsection 66(12.66) provides a "look-back" period of one year.

The French version of subsection 66(12.66) is amended to insert paragraph (*a*.1), which was inadvertently omitted when the subsection was amended by subsection 104(5) of S.C. 1998, c. 19 (formerly Bill C-28), and to correct certain grammatical errors.

ITA
66(12.66)(*b*)(ii)

Paragraph 66(12.66)(*b*) of the Act describes those expenses eligible for renunciation in the look-back period. The expenses described by subparagraph 66(12.66)(*b*)(ii) are expenses that "would be described in paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6) of the Act if the expression "paragraphs (*a*), (*b*), (*c*), (*d*), (*f*) and (*g*)" in that definition were read as "paragraphs (*a*), (*d*) and (*f*)". The wording in subparagraph 66(12.66)(*b*)(ii) is consistent with paragraph (*h*) of the definition "Canadian exploration expense" in subsection 66.1(6) as that paragraph read before December 6, 1996. After December 5, 1996, paragraph (*h*) of the definition contains a reference to paragraph (*g*.1) of the definition.

Subparagraph 66(12.66)(*b*)(ii) is amended, effective after December 5, 1996, as a consequence of the 1996 amendment to paragraph (*h*) of the definition "Canadian exploration expense".

The closing words of subsection 66(12.66) currently refer to "the last day of the year". The closing words are amended, effective upon Royal Assent, to clarify that the reference to "the year" means the preceding year referred to in paragraphs 66(12.66)(*a*.1), (*c*) and (*e*).

Definitions

ITA
66(15)

Subsection 66(15) of the Act contains various definitions for the purposes of section 66.

"Canadian resource property"

A "Canadian resource property" is defined to include various interests in oil and gas and mineral resources located in Canada. The cost of a Canadian resource property is either a Canadian oil and gas property expense or a Canadian development expense.

Paragraphs (*d*) and (*e*) of the definition "Canadian resource property" are amended, effective for property acquired after Announcement Date, to ensure that a rental or royalty described therein will not qualify as a Canadian resource property unless the person paying the rental or royalty has an interest in the property to which the rental or royalty relates and 90% or more of the rental or royalty is payable out of the production from the property.

Paragraph (*g*) of the definition "Canadian resource property" describes any right or interest in any property described in any of paragraphs (*a*) to (*f*) of that definition, other than a right or interest that the taxpayer has by reason of being a beneficiary of a trust. Paragraph (*g*) of the definition is amended to clarify that a right or interest in any property described in paragraphs (*a*) to (*f*) of the definition, which is acquired after Announcement Date, does not include any right or interest that the taxpayer may have by reason of being a member of a partnership.

"flow-through share"

A flow-through share is a share of the capital stock of a principal-business corporation, or a right to such a share, that is issued to a person pursuant to an agreement in writing under which the corporation agrees to incur resource expenses and renounce those expenses to that person.

The definition is amended to exclude a prescribed right from the class of rights that qualifies as flow-through shares. A "prescribed right" is proposed to be defined in new subsections 6202.1(1.1) and (2.1) of the Regulations. This amendment ensures that restrictions on the type of shares that may qualify as flow-through shares, currently found in subsections 6202.1(1) and (2) of the Regulations, also apply to rights to acquire shares. For additional information, see the commentary to subsections 6202.1(1.1) and (2.1) of the Regulations included in Appendix F.

The amended definition "flow-through share", which applies to agreements made after Announcement Date, no longer includes the phrase, "any interest acquired in such a share by a person pursuant to such an agreement". This phrase is being deleted because the amended definition is sufficiently comprehensive to include any interest in property that qualifies as a flow-through share.

Non-Arm's Length Partnerships

ITA
66(17)

Subsection 66(12.66) of the Act permits certain Canadian exploration expenses incurred in a particular calendar year to be treated as having been incurred at the end of the preceding calendar year ("look-back rule") for the purpose of the flow-through share rules. The look-back rule does not apply where the flow-through share subscriber and the renouncing corporation do not deal with each other at arm's length. This limitation prevents the look-back rule from being used to accelerate deductions in non-arm's length situations.

Subsection 66(17) of the Act defines the circumstances in which a non-arm's length relationship between a partnership and a renouncing corporation is considered to exist during the first 60 days ("look-back period") following the end of the calendar year in which the flow-through share agreement was made. Subsection 66(17) is amended to reflect the extension in the look-back period from 60 days to one year. This amendment generally applies to expenses incurred after 1996, but not to expenses incurred in January or February of 1997 in respect of an agreement made in 1995.

Clause 28

Canadian Development Expense

ITA
66.2(5)

Subsection 66.2(5) of the Act contains the definitions "Canadian development expense" and "cumulative Canadian development expense" of a taxpayer. The cost of property described in paragraph (*b*), (*e*) or (*f*) of the definition "Canadian resource property" in subsection 66(15) or any right to or interest in such property is referenced in paragraph (*e*) of the definition "Canadian development expense" and an amount in respect property described in paragraphs (*b*), (*e*) or (*f*) of the definition "Canadian resource property" is referenced in the description of F in the definition "cumulative Canadian development expense". Paragraph (*e*) of the definition

"Canadian development expense" and the description of F in the definition "cumulative Canadian development expense" are amended, applicable after Announcement Date, as a consequence of changes to the definition "Canadian resource property". Among other things, the amended definition "Canadian resource property" clarifies that a right or interest that the taxpayer has by reason of being a member of a partnership does not qualify as a Canadian resource property.

Clause 29

Canadian Oil and Gas Property Expense

ITA
66.4(5)

Subsection 66.4(5) of the Act contains the definitions "Canadian oil and gas property expense" and "cumulative Canadian oil and gas property expense". The cost of property described in paragraph (*a*), (*c*) or (*d*) of the definition "Canadian resource property" in subsection 66(15) or a right to or interest in such property is referenced in paragraph (*a*) of the definition "Canadian oil and gas property expense" and an amount in respect of property described in paragraphs (*a*), (*c*) or (*d*) of the definition "Canadian resource property" is referenced in the description of F in the definition "cumulative Canadian oil and gas property expense". Paragraph (*a*) of the definition "Canadian oil and gas property expense" and the description of F in the definition "cumulative Canadian oil and gas property expense" are amended, applicable after Announcement Date, as a consequence of changes to the definition "Canadian resource property". Among other things, the amended definition "Canadian resource property" clarifies that a right or interest that the taxpayer has by reason of being a member of a partnership does not qualify as a Canadian resource property.

Clause 30

Exploration and Development Expenses – Successor Rules

ITA
66.7

Section 66.7 of the Act provides rules (commonly known as the "successor rules") in respect of Canadian exploration and development expenses, foreign exploration and development expenses, foreign resource expenses, Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses, respectively. The successor rules establish the parameters within which unused resource expenses of an "original owner" may be deducted by a corporation ("successor corporation") where the successor corporation acquires all or substantially all of the resource properties of the previous owner.

Amalgamation – Partnership Property

ITA
66.7(10.1)

Subsection 66.7(10) of the Act treats a corporation as a successor corporation for the purposes of the successor rules in section 66.7 following an acquisition of control (or a change in the tax-exempt status) of the corporation. A rule in paragraph 66.7(10)(*j*) deems the corporation to own its percentage share of the properties owned by a partnership of which it was a member at the time of the acquisition of control. This "look-through rule" permits the deduction of resource expenses against income from, and proceeds of disposition of, the properties owned by the partnership at the time of the acquisition of control. No similar rule currently exists which would allow a new corporation formed on an amalgamation (other than an amalgamation to which subsection 87(2.1) applies) to deduct resource expenses against income from properties owned by a partnership in which a predecessor corporation was a member at the time of the amalgamation.

New subsection 66.7(10.1) of the Act applies to an amalgamation to which subsection 87(1.2) does not apply and provides a look-through rule similar to the rule in paragraph 66.7(10)(*j*) of the Act. It does so by deeming the predecessor corporation to have owned a portion of the properties owned by a partnership immediately before the amalgamation and to have disposed of them to the new corporation formed on the amalgamation. Thus, subsection 66.7(10.1) allows a new corporation, to the extent permitted under subsections 66.7(1) to (5), to deduct from the resource pools of the predecessor corporation, amounts relating to the new corporation's share of the income from properties owned by a partnership in which a predecessor corporation was a member at the time of the amalgamation. New subsection 66.7(10.1) applies to amalgamations that occur after 1996.

Clause 31

Inadequate Consideration

ITA
69

Section 69 of the Act provides a series of rules dealing primarily with transactions between non-arm's length persons or between persons on non-arm's length terms.

ITA
69(1)(*b*)(iii)

Subsection 69(1) of the Act provides rules that deal with gifts and non-arm's length dispositions of property, except where such transactions are expressly covered by other provisions in the Act that apply to the gift or other disposition. The English version of subparagraph 69(1)(*b*)(iii) is amended to correct an editorial error, by deleting the word "and" at the end of the subparagraph.

This amendment applies to dispositions that occur after December 23, 1998.

Disposition of Petroleum, etc.

ITA
69(6)

Subsection 69(6) of the Act treats a taxpayer who disposes of production from an oil or gas well or mineral resource in Canada to the Crown (or an emanation of the Crown) at less than fair market value as having disposed of that production for its fair market value. Subsection 69(6) is amended, effective after Announcement Date, to remove the requirement that the production be disposed of by reason of "an obligation imposed by statute or a contractual obligation substituted for an obligation imposed by statute". For additional information, see the commentary to paragraphs 12(1)(*o*) and 18(1)(*m*).

Clause 32

Inter Vivos Transfer of Farm Property

ITA
73(3)

Subsection 73(3) of the Act provides a tax-deferral for an *inter vivos* transfer of farm property by a taxpayer to a child of the taxpayer.

For dispositions made after Announcement Date, paragraph 73(3)(*c*) is amended to clarify that subsection 73(3) does not apply if the anti-avoidance rule in subsection 69(11) of the Act applies. When applicable, subsection 69(11) denies the benefit of the rollover by treating the vendor's proceeds of disposition to be equal to the fair market value of the transferred property notwithstanding any other provision of the Act.

ITA
73(4)

Subsection 73(4) of the Act provides a tax-deferral for an *inter vivos* transfer of shares of a family farm corporation or an interest in a family farm partnership by a taxpayer to a child of the taxpayer.

For dispositions made after Announcement Date, paragraph 73(4)(*b*) is amended to clarify that subsection 73(4) does not apply if the anti-avoidance rule in subsection 69(11) of the Act applies. When applicable, subsection 69(11) denies the benefit of the rollover by treating the vendor's proceeds of disposition to be equal to the fair market value of the transferred property notwithstanding any other provision of the Act.

Clause 33

Transfer of Property to Corporation by Shareholders

ITA
85

Section 85 of the Act provides rules for tax-deferred transfers of certain types of properties by a taxpayer to a taxable Canadian corporation in exchange for shares.

ITA
85(1)(*d*.1), (*d*.11) and (*d*.12)

Subsection 85(1) of the Act provides a tax deferral for the transfer of various types of property by a taxpayer to a taxable Canadian corporation for consideration that includes shares of the corporation's capital stock. In general, tax deferral may be achieved if the taxpayer and the corporation jointly elect that the proceeds of disposition of the taxpayer and the eligible capital expenditure of, or cost to, the corporation are deemed to be less than the fair market value of the property transferred.

Paragraph 85(1)(*d*.1) generally reduces, for the corporation that has acquired an eligible capital property (ECP), the gain that would be included in income under paragraph 14(1)(*b*) of the Act on a subsequent disposition of the property. Paragraph 85(1)(*d*.1) adjusts the gain in order to take into account the 1988 change of the rate of income inclusion and expenditure deductibility from 1/2 to 3/4, by adjusting the calculation of variable Q in the definition "cumulative eligible capital" in subsection 14(5). (Variable Q generally represents, for the period prior to the taxpayer's "adjustment time", the difference between ECP deductions claimed under paragraph 20(1)(*b*) of the Act and gains from prior dispositions of eligible capital property by the taxpayer.) Paragraph 85(1)(*d*.1) adjusts variable Q only for the purposes of calculating the amount to be included in a taxpayer's income under paragraph 14(1)(*b*), but not for the purpose of calculating the corporation's cumulative eligible capital balance for other purposes, such as the claiming of ECP deductions. Specifically, the adjustment of variable Q adjusts the value of variables B and C in the formula in paragraph 14(1)(*b*). (Variable B is affected indirectly, since variable Q affects variable F in the calculation of the cumulative eligible capital balance.)

Paragraph 85(1)(*d*.1) is amended concurrently with the addition of new paragraph 85(1)(*d*.11) of the Act. New paragraph 85(1)(*d*.11) generally applies to ensure that an amount that would have been recaptured ECP deductions to the taxpayer under subsection 14(1), if the taxpayer had disposed of the eligible capital property for fair market value proceeds, may be subject to recapture in the hands of the corporation upon a subsequent sale of the property. This result is effectively achieved by adding an allocation of the potential recapture to the taxpayer (i.e., variable F of the taxpayer) simultaneously to the corporation's eligible capital expenditures and aggregate ECP deductions (i.e., variables A and F respectively in the definition "cumulative eligible capital"). This adjustment applies only for the purpose of calculating the amount to be included in income of the corporation under subsection 14(1) upon the subsequent disposition of eligible capital property. Variable F of the taxpayer is apportioned to the corporation in the same proportion as the fair market value of the property transferred is to the fair market value of total eligible capital property of the taxpayer before the transfer.

Because new paragraph 85(1)(*d*.11) now accommodates variable F of the taxpayer, paragraph 85(1)(*d*.1) is amended to add 1/2 of the taxpayer's variable Q amount directly to the corporation's variable C amount in paragraph 14(1)(*b*), rather adjusting variable Q of the corporation (and thus variable F as well).

New paragraph 85(1)(*d*.12) of the Act is added, concurrently with new paragraph 85(1)(*d*.11), to ensure that any recaptured ECP deductions actually reported by a taxpayer on the rollover is not included in the amount added to variables A and F respectively in computing the cumulative eligible capital of the corporation. This could happen, for instance, where the agreed amount of proceeds of disposition is more than 4/3 of the taxpayer's cumulative eligible capital balance before the transfer and the taxpayer has previously claimed ECP deductions.

The amendments apply in respect of dispositions that occur afterAnnouncement Date.

Example of 85(1)(d.1) and (d.11)

Mr. X purchased an eligible capital property in 1984 (when the income inclusion rate for eligible capital property was one half) at a cost of $300,000. This was the first and only eligible capital property held in respect of his business. Mr. X claimed deductions of $40,650 under paragraph 20(1)(b) of the Act before his "adjustment time" (in the case of Mr. X, January 1, 1988), and of $11,482 subsequent to that time. Mr. X now transfers the property to a corporation in circumstances to which subsection 85(1) applies. Immediately before the time of the transfer, the fair market value of the property is $500,000. Mr. X and the corporation agree that the proceeds of disposition to Mr. X will be 4/3 of the cumulative eligible capital balance of $152,543, calculated as follows:

Eligible capital expenditure	*$300,000*
Rate applicable in 1984	*50%*
	150,000
Depreciation before 1988	*< 40,650>*
Cumulative eligible capital at adjustment time	*109,650*
"C" amount: 3/2 of 109,350	*164,025*
"D" amount: depreciation before 1988	*40,650*
"P" amount: depreciation after 1987	*11,482*
"Q" amount: depreciation before 1988	*<40,650>*
Cumulative eligible capital of Mr. X	*152,543*

Upon the subsequent sale of the property by the corporation for actual proceeds of disposition of $500,000, the amount included in the corporation's income under subsection 14(1) is calculated as follows:

Agreed amount of eligible capital expenditure (4/3 of $152,543)	*$203,391*
3/4 eligible capital expenditure rate	*75%*
"A" amount in cumulative eligible capital balance of corporation	*152,543*

14(1)(a) calculation for corporation:

Proceeds	*$500,000*		
3/4 rate applicable	*75%*		
"E" amount in cumulative eligible capital balance of corporation		*375,000*	
Excess		*222,457*	
"F" for corporation: bumped by 85(1)(d.11) ($40,650 + $11,482)		*52,132*	
14(1)(a) income: lesser of "F" and excess			*$ 52,132*

14(1)(b) calculation for corporation:

Excess (as above)	*222,457*	
Less: "B" amount: amount "F", as bumped by 85(1)(d.11)	*52,132*	
"C" amount: ½ of "Q" (above), as bumped by 85(1)(d.1)	*20,325*	
Net	*150,000*	
multiply by 2/3	*2/3*	
14(1)(b) income		*100,000*
Total 14(1) income inclusion to corporation		*$152,132*

Clause 34

Eligible Distribution Not Included in Income

ITA
86.1(2)

Subsection 86.1(2) of the Act defines an "eligible distribution" for the purposes of the tax-deferral that applies with respect to distributions to Canadian resident shareholders of spin-off shares by a foreign corporation. Subsection 86.1(2) is amended in three respects.

First, subparagraph 86.1(2)(*c*)(ii) requires that a taxpayer's original shares be included in a class that is widely held and actively traded on a prescribed stock exchange in the United States at the time of the distribution (section 3201 of the Regulations prescribes certain U.S. stock exchanges). The condition that the share be actively traded on a U.S. stock exchange is amended effective after 1999 to require that the taxpayer's original shares of the foreign corporation be, at the time of the distribution, widely held and

- actively traded on a prescribed stock exchange in the United States, or

- required, under the *Securities Exchange Act of 1934* of the United States, to be registered with the Securities and Exchange Commission (and are so registered).

In general, a class of shares of a U.S. corporation must be registered under the *Securities Exchange Act of 1934* with the Securities and Exchange Commission ("SEC") if more than 500 shareholders own shares of the class, the corporation has more than $10 million in assets and shares of the class will be traded on a national securities exchange. Thus this SEC registration requirement applies if it is expected that the shares will trade on a national securities exchange, with the SEC filing and public disclosure requirements thereafter applying to the corporation regardless of whether any of its issued shares trade in the future on the exchange.

Second, the references in subparagraphs 86.1(2)(*c*)(iii) and 86.1(2)(*e*)(vi) to the *United States Internal Revenue Code* are replaced by "the *Internal Revenue Code of 1986* of the United States, as amended from time to time".

Third, subparagraph 86.1(2)(*e*)(i) is amended consequential to the amendment to subparagraph 86.1(2)(*c*)(ii) described above.

Clause 35

Amalgamations

ITA
87

Section 87 of the Act provides rules that apply where there has been an amalgamation of two or more taxable Canadian corporations to form a new corporation.

Patronage Dividends

ITA
87(2)(*g*.5)

New paragraph 87(2)(*g*.5) of the Act deems a new corporation formed on an amalgamation to be the same corporation as and a continuation of each of the predecessor corporations for the purpose of section 135 of the Act. This paragraph, which applies to amalgamations that occur after 1997, ensures that the rules in section 135 concerning the deduction for and inclusion in income of patronage dividends continue to apply where a cooperative corporation or a customer of a cooperative corporation amalgamates with one or more other corporations between the time a cooperative corporation makes an allocation in proportion to patronage and the time that the patronage dividend is paid. This amendment ensures that payments made under subsection 135(1) by the new corporation in satisfaction of allocations made by a predecessor corporation will be deductible by the new corporation. In addition, new paragraph 87(2)(*g*.5) ensures that the deductibility of an amount paid to a new corporation formed on the amalgamation of the cooperative corporation's customer and another corporation will not be affected by the amalgamation.

Part I.3 and Part VI Tax

ITA
87(2)(*j*.91)

Subsection 88(1) of the Act sets out rules relating to the winding-up of a subsidiary into a parent corporation that owns at least 90% of each class of shares of the subsidiary. A number of the rules that apply to amalgamations under subsection 87(2) of the Act also apply to windings-up under subsection 88(1).

Paragraph 87(2)(*j*.91) allows a new corporation, or, in the case of a winding-up under subsection 88(1), a parent corporation, to be considered as a continuation of its predecessors or subsidiary, as the case may be, for the purposes of determining an amount deductible under subsection 181.1(4) or 190.1(3) of the Act. Those provisions relate, respectively, to the deduction from a corporation's tax otherwise payable under Part I.3 of the Act of an amount in respect of its Canadian surtax, and the deduction from a financial institution's tax otherwise payable under Part VI of the Act of an amount in respect of its tax under Part I of the Act.

Paragraph 87(2)(*j*.91) is amended to clarify that it does not affect the fiscal period of, or tax payable by, any corporation for any taxation year that ends prior to an amalgamation, or, by virtue paragraph 88(1)(*e*.2), the commencement of a winding-up under subsection 88(1).

This amendment to paragraph 87(2)(*j*.91) applies to amalgamations that occur, and windings-up that begin, after Announcement Date.

Subsection 13(4.2) Election

ITA
87(2)(*l*.4)

New paragraph 87(2)(*l*.4) of the Act is added to provide that, for the purposes the rules in new subsection 13(4.3) and paragraph 20(16.1)(*b*) of the Act in respect of which an election is made under new subsection 13(4.2), the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation. This new provision also applies in respect of the winding up of a corporation to which section 88 of the Act applies, as a result of the application of paragraph 88(1)(*e*.2). New paragraph 87(2)(*l*.4) applies to amalgamations that occur, and windings up that begin, after Announcement Date.

Employees Profit Sharing Plan

ITA
87(2)(*r*)

New paragraph 87(2)(*r*) of the Act preserves an election under subsection 144(10) in connection with an employees profit sharing plan that was made by a predecessor corporation before an amalgamation. Paragraph 88(1)(*e*.2) of the Act provides that this rule also applies, with appropriate modifications, for the purposes of the rules relating to the winding-up of a subsidiary corporation into its parent corporation.

This amendment applies to amalgamations that occur, and windings-up that begin, after 1994.

UI Premium Tax Credit

ITA
87(2)(*mm*)

Paragraph 87(2)(*mm*) of the Act ensures that an amalgamated corporation will be treated as a continuation of, and the same corporation as, each of its predecessor corporations for the purposes of the provisions relating to UI premium tax credit. That paragraph is repealed as a consequence of the repeal of the provisions relating to the UI premium tax credit. For additional information, see the commentary to section 126.1.

This change applies in respect of amalgamations that occur, and to windings-up that begin, after the 90th day after Announcement Date.

Quebec Credit Unions

ITA
87(2.3)

New subsection 87(2.3) of the Act provides a special rule that applies to an "investment deposit" of a Quebec credit union in another Quebec credit union (the "predecessor corporation"). This rule applies where the credit union's investment deposit in the predecessor corporation is disposed of because of an amalgamation of credit unions that includes the predecessor corporation with that amalgamation being governed by section 689 of the *Act Respecting Financial Services Cooperatives,* R.S.Q., 2001, c. C-67.3. The credit union's investment deposit will, if certain conditions are met, be deemed to be a share of the capital stock of the predecessor corporation having an adjusted cost base and paid up capital equal to the adjusted cost base of the investment deposit to the credit union. The conditions that must be met are that

- immediately before the amalgamation the investment deposit must be an investment deposit (to which section 425 of the *Savings and Credit Unions Act,* R.S.Q., 2001, c. C-4.1 applies) in an investment fund of the predecessor corporation; and

- on the amalgamation the credit union disposes of the investment deposit for consideration that consists solely of shares of the capital stock of the new corporation.

This amendment applies to amalgamations that occur after June 2001.

Flow-Through Shares

ITA
87(4.4)

Subsection 87(4.4) of the Act applies where there is an amalgamation of two or more corporations and a predecessor corporation of the new corporation formed on the amalgamation had entered into a flow-through share agreement. The rules in subsection 87(4.4) generally enable the new corporation to renounce certain resource-related expenses incurred after the amalgamation to a flow-through shareholder.

Paragraph 87(4.4)(*c*) sets out certain conditions that must be satisfied for a new corporation to renounce expenses to a flow-through shareholder of a predecessor corporation. This paragraph is amended, effective for amalgamations that occur after 1997, to delete the unnecessary reference to the definition "flow-through share" in subsection 66(15) of the Act and to ensure that this paragraph is consistent with the amended definition "flow-through share" in subsection 66(15).

Paragraph 87(4.4)(*d*) sets out certain conditions that must be satisfied to qualify for the relief provided in subsection 87(4.4). Subparagraph 87(4.4)(*d*)(i) requires the new corporation to issue a new share to the flow-through share subscriber in consideration for the flow-through share. Current subparagraph 87(4.4)(*d*)(i) does not, however, contemplate the transfer of a flow-through share by the flow-through share subscriber ("original flow-through shareholder") prior to an amalgamation. Consequently, subsection 87(4.4) does not accommodate a renunciation by the new corporation to an original flow-through shareholder of expenses incurred by the new corporation if the original flow-through shareholder transferred those shares to another person. Subparagraph 87(4.4)(*d*)(i) is amended, effective for amalgamations that occur after 1997, to accommodate the issuance of a new share to a person other than the original flow-through shareholder. This amendment ensures that the new corporation may renounce resource expenses incurred after an amalgamation to an original flow-through shareholder on the same basis as if that person had owned the flow-through share at the time of the amalgamation.

Rules Applicable in Respect of Certain Mergers – "Triangular Amalgamations"

ITA
87(9)

Subsection 87(9) of the Act contains rules that apply on a "triangular amalgamation" – an amalgamation in which shares of the parent corporation are issued in exchange for shares of the amalgamating corporations.

New paragraph 87(9)(*a*.21), which is effective for amalgamations that occur after 1997, provides that a share of the parent issued to a shareholder on a triangular amalgamation is considered, for the purpose of paragraph 87(4.4)(*d*), to be a share issued by the new corporation and that a right to acquire a share of the parent issued to a person on a triangular amalgamation is deemed to be in consideration for a right to acquire a share of the new corporation. New paragraph 87(9)(*a*.21) therefore ensures that the requirements in subparagraph 87(4.4)(*d*)(i) and (ii) that the new corporation issue a share or right to a person are satisfied. As a result, a new corporation may renounce expenditures to a flow-through shareholder of a predecessor corporation in accordance with a flow-through share agreement concluded before the triangular amalgamation.

Clause 36

Winding-up of a Corporation

ITA
88(1)

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation. Subsection 88(1) provides rules that apply where a subsidiary has been wound up into its parent corporation in circumstances where both the parent and the subsidiary are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the capital stock of the subsidiary.

ITA
88(1)(*c*.1)

Subparagraph 88(1)(*a*)(iii) of the Act generally provides that property of a subsidiary corporation is deemed to have been disposed of on its winding-up for proceeds of disposition equal to its cost amount to the subsidiary immediately before the winding-up. Under subparagraph 88(1)(*c*)(ii) of the Act, the cost of such property to the parent corporation is equal to such proceeds of disposition. Paragraph 88(1)(*c*.1) of the Act ensures that an amount that would have been recaptured depreciation to the subsidiary under subsection 14(1) of the Act, if the subsidiary had instead disposed of the eligible capital property for fair market value proceeds, is subject to possible recapture in the hands of the parent upon a subsequent sale of the property.

Paragraph 88(1)(*c*.1) is renumbered as subparagraph 88(1)(*c*.1)(ii) and remains unchanged. Paragraph 88(1)(*c*.1) is further amended by the addition of new subparagraph (i), which ensures that eligible capital property deductions claimed under paragraph 20(1)(*b*) of the Act by the subsidiary after its "adjustment time" (as defined in subsection 14(5) of the Act, i.e., generally the beginning of the first taxation year of the subsidiary that starts after June 30, 1988) are included in the amount subject to potential recapture.

Paragraph 88(1)(*c*.1) applies to a parent corporation similarly to the application of paragraphs 85(1)(*d*.1) and (*d*.11) of the Act to a transferee corporation. For additional information, refer to the commentary to those paragraphs for an example of that application.

Amended paragraph 88(1)(*c*.1) applies in respect of dispositions that occur after Announcement Date.

ITA
88(1)(*c*.3)(vi) and (vii)

Paragraph 88(1)(*c*) of the Act generally provides that the cost to the parent of each property distributed to it on the winding-up of a subsidiary is equal to the subsidiary's proceeds of disposition plus, where the property is a capital property and is not an ineligible property, an amount determined under paragraph 88(1)(*d*) in respect of the property. "Ineligible property" is described in subparagraphs 88(1)(*c*)(iii) to (vi). Pursuant to subparagraph 88(1)(*c*)(vi), ineligible property includes any property distributed to the parent on the winding-up if, as part of the series of transactions or events that includes the winding-up, the property or property acquired in substitution for such property was acquired by a person or persons described in clause 88(1)(*c*)(vi)(B). Property acquired in substitution for property distributed on the winding-up ("substituted property") has its ordinary meaning and an extended meaning found in paragraph 88(1)(*c*.3) of the Act.

Paragraph 88(1)(*c*.3) of the Act provides that substituted property includes property described in subparagraphs 88(1)(*c*.3)(i) and (ii) but excludes property described in subparagraphs 88(1)(*c*.3)(iii) to (v). Subparagraph 88(1)(*c*.3)(i) provides that, for the purpose of clause 88(1)(*c*)(vi)(B), substituted property includes property (other than a "specified property") owned by a person after the acquisition of control of the subsidiary where the fair market value of the property is wholly or partly attributable to property distributed to the parent on the winding-up. Subparagraph 88(1)(*c*.3)(iv) ensures that property that would be substituted property under the ordinary meaning of the term will not be substituted property if it is not owned by the person after the acquisition of control.

Example 1 of the explanatory notes to the introduction of paragraph 88(1)(*c*.3) [see the explanatory notes to S.C. 1998, c.19 (formerly Bill C-28)] describes a scenario under the heading *Safe Income Crystallization* that illustrates the application of subparagraph 88(1)(*c*.3)(iv) to a situation involving a safe income crystallization prior to a takeover. In that example, Sco, a taxable Canadian corporation, owns 15% of Tco, a publicly traded taxable Canadian corporation. Another corporation ("Pco") makes a takeover offer for all the shares of Tco. In anticipation of the sale of the Tco shares, Sco incorporates Newco and transfers, on a tax-deferred basis under section 85 of the Act, all of its Tco shares to Newco in exchange for Newco shares. The adjusted cost base and the paid-up capital of the Newco shares are then increased by the amount equal to the so-called "safe income" attributable to the Tco shares. Immediately thereafter, Sco sells the Newco shares to Pco for cash and Newco is wound up into Pco.

In the example, subparagraph 88(1)(*c*.3)(iv) ensures that the Newco shares are not substituted property since Sco did not own the Newco shares after the acquisition of control of Newco by Pco. However, assuming that Tco is subsequently wound up into Pco, the non-depreciable capital property ("bump property") owned by Tco at the time of the acquisition of control of Tco would be ineligible property since, as part of the series of transactions or events that includes the winding up of Tco, property substituted for the bump property (i.e., the 15% of the Tco shares) would have been acquired by a specified shareholder of Tco (i.e., Newco) and would have been owned by Newco after the acquisition of control of Tco.

New subparagraphs 88(1)(*c*.3)(vi) and (vii) of the Act, which apply to windings-up that begin after 1997, are enacted to ensure that certain shares or debt will not be substituted property even if they are owned by a specified shareholder after the acquisition of control of the subsidiary. Subparagraph 88(1)(*c*.3)(vi) provides that shares or debt of the subsidiary will not be substituted property if such shares or debt are owned by the parent immediately before the winding-up of the subsidiary. Thus, in the example discussed above, the Tco shares, which are owned by Pco immediately before the winding-up of Tco, would not be substituted property.

Subparagraph 88(1)(*c*.3)(vii) provides that a share or debt of a corporation will not be substituted property if the fair market value of the share or debt is not attributable, at any time after the winding-up process begins, to property acquired by the parent on the winding-up. This exemption would apply, for example, if an individual ("Mr. S"), who is a specified shareholder of Tco, incorporates Newco in contemplation of the takeover of Tco and transfers the Tco shares to Newco. Mr. S then transfers the Newco shares to Sco. Immediately after the increase in the adjusted cost base of the shares of Newco (i.e., following the safe income crystallization) Sco sells the Newco shares to Pco. In this scenario, the Sco shares owned by Mr. S after the sale would not be substituted property by reason of new subparagraph 88(1)(*c*.3)(vii).

ITA
88(1)(*c*.4)(i)

Paragraph 88(1)(*c*.4) of the Act defines "specified property" for the purposes of subparagraphs 88(1)(*c*.3)(i) and (v) of the Act. Specified property is excluded from the extended meaning of a substituted property found in subparagraph 88(1)(*c*.3)(i). Subparagraph 88(1)(*c*.4)(i) is amended to include, within the definition "specified property", shares of the parent issued for consideration that consists solely of money. This amendment, which applies to windings-up that begin after 1999, ensures that a specified shareholder that participates in a takeover by acquiring shares of the parent for cash consideration will not be considered to have acquired substituted property within the meaning assigned by subparagraph 88(1)(*c*.3)(i).

ITA
88(1)(*e*.6)

Paragraph 88(1)(*e*.6) of the Act permits a parent corporation to deduct the amount of a subsidiary's charitable gifts, gifts to Her Majesty, gifts to certain cultural institutions and ecological gifts, to the extent that they were not deducted by the subsidiary prior to the time of its winding-up. Paragraph 88(1)(*e*.6) is amended, consequential to the addition of new subsection 248(30) of the Act, to allow the parent to deduct the eligible amount of a gift made after Announcement Date that was not deducted by the subsidiary. For additional details, see the commentary to new subsection 248(30).

Clause 37

Taxable Canadian Corporation

ITA
89

Section 89 of the Act defines certain terms that apply to corporations and their shareholders.

Definitions

ITA
89(1)

"capital dividend account"

The French-language versions of paragraphs (*f*) and (*g*) of the definition "capital dividend account" in subsection 89(1) of the Act are amended to clarify that the amounts described in those paragraphs relate to distributions from a trust. This technical change does not represent a change in policy.

These amendments apply to elections in respect of capital dividends that became payable after 1997.

"taxable Canadian corporation"

Paragraph (*b*) of the definition "taxable Canadian corporation" in subsection 89(1) of the Act is amended to clarify that a farming or fishing insurer to which paragraph 149(1)(*t*) of the Act applies is a taxable Canadian corporation. This amendment applies in respect of taxation years that end after 1999.

Clause 38

Disposition of Shares of Foreign Affiliate

ITA
93

Subsection 93(1) of the Act permits a corporation resident in Canada that disposes of a share of a foreign affiliate of the corporation to elect to receive the proceeds of disposition of the share as a dividend (rather than as proceeds of disposition). This election allows the corporation to obtain the benefit of any exempt or taxable surplus that relates to the share of that affiliate without the need for a dividend to be declared by that affiliate before the disposition.

Disposition of Foreign Affiliate Shares

ITA
93(1.4) to (1.6)

In general terms, subsection 93(1.2) of the Act provides that, where a particular corporation resident in Canada or a foreign affiliate of the particular corporation (each of which is referred to as the "disposing corporation") would, but for subsection 93(1.2), have a taxable capital gain from a partnership from the disposition by the partnership of shares of a class of the capital stock of a foreign affiliate of the particular corporation and the disposing corporation elects in respect of the gain, the amount designated in the election (the "designated amount") will reduce the taxable capital gain and be grossed up and recharacterized as a dividend received on the share by the particular corporation from the disposing corporation.

Section 93 is amended by adding new subsections 93(1.4) to (1.6). New subsection 93(1.4) provides for a substantive rule, while new subsections 93(1.5) and (1.6) define the expressions "specified vendor" and "specified purchaser" for the purpose of subsection 93(1.4).

New subsection 93(1.4) applies if a corporation or partnership (defined in subsection 93(1.5) as the "specified vendor") that is

- a foreign affiliate of a particular corporation resident in Canada, or

- a partnership of which a foreign affiliate of the particular corporation resident in Canada is a member

disposes of a particular share of another foreign affiliate (referred to as the "transferred affiliate") of the particular corporation to another corporation or partnership (defined in subsection 93(1.6) as the "specified purchaser") that

- is the particular corporation (paragraph 93(1.6)(*a*)),
- is another corporation resident in Canada with whom the particular corporation does not deal at arm's length (paragraph 93(1.6)(*b*)),
- is a foreign affiliate of the particular corporation or of that other corporation resident in Canada (paragraph 93(1.6)(*c*)), or
- is a partnership any member of which is a corporation described above (paragraph 93(1.6)(*d*)).

If new subsection 93(1.4) applies, paragraph 93(1.4)(*a*) deems the particular share not to be "excluded property" (as defined in subsection 95(1)) to the specified vendor unless any of subsection 88(3) (which subsection relates to specified types of dissolutions) or paragraphs 95(2)(*c*), (*d*) or (*e*) (which paragraphs relate to specified types of corporate reorganizations) of the Act applied to the disposition of the particular share. Paragraph 93(1.4)(*a*) prevents duplication of surplus amounts and increases in cost bases of shares of foreign affiliates that could otherwise arise on a sale of shares of the foreign affiliate where, after the disposition, the foreign affiliate continues to have surplus amounts in respect of the particular corporation or another corporation with whom the particular corporation does not deal at arm's length.

For additional information, refer to the commentary to the definition "excluded property" in subsection 95(1).

If new subsection 93(1.4) applies, paragraph 93(1.4)(*b*) deems the cost amount of the particular share to the specified purchaser to be equal to the specified vendor's proceeds on the disposition. Paragraph 93(1.4)(*b*) ensures that the specified purchaser's cost base on the particular share is reduced by any deemed dividend received by the specified vendor by virtue of an election made under subsection 93(1) or (1.2) in respect of the disposition. As well, where the cost base of the shares is increased because the specified vendor realized a gain on the disposition of the shares, the specified vendor will realize foreign accrual property income since the shares are deemed not to be excluded property.

New subsections 93(1.4) to (1.6) apply to dispositions that occur after Announcement Date, other than dispositions required to be made under an agreement in writing made by a vendor on or before Announcement Date.

Clause 39

Foreign Affiliates

ITA
95

Section 95 of the Act defines a number of terms and provides rules relating to the taxation of resident shareholders of foreign affiliates.

Global Section 95 Election

In this set of proposals, there are a number of amendments to section 95 of the Act, and to section 5907 of the Regulations, that apply to taxation years, of a foreign affiliate of a taxpayer, that begin or end after various specified dates. However, where a taxpayer so elects in writing and files the election (referred to as the "Global Section 95 Election") with the Minister of National Revenue before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which these amendments are assented to, all of those measures apply to taxation years of all foreign affiliates, of the taxpayer, that begin after 1994. Notwithstanding subsections 152(4) to (5) of the Act, the Minister of National Revenue can make any assessment of a taxpayer's tax, interest and penalties payable under the Act for any of those taxation years that begin before [Announcement Date + 1] that is necessary to take these amendments into account.

Note that the Fresh Start Section 95 Election (described below) and the Global Section 95 Election are separate elections.

The following amendments to the Act and to the Regulations are covered by the Global Section 95 Election package:

(A) Amendments to section 95 of the Act that, absent a Global Section 95 Election by the taxpayer, apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date:

- paragraphs (*a*), (*c*) and (*c*.1) of the definition "excluded property" in subsection 95(1),
- the description of B in the definition "foreign accrual property income" in subsection 95(1),
- subclauses 95(2)(*a*)(i)(A)(II) and (B)(II),
- subclauses 95(2)(*a*)(ii)(D)(IV) to (V1),
- clause 95(2)(*a*)(ii)(E),
- subparagraphs 95(2)(*a*)(v) and (vi),
- subparagraph 95(2)(*a*.1)(i),
- the portion of paragraph 95(2)(*f*) that is between subparagraphs 95(2)(*f*)(ii) and (iii),
- paragraphs 95(2)(*f*.1), (*f*.2), (*g*.3), (*h*) and (*i*), and
- subsection 95(3.1);

(B) Amendments to section 95 of the Act that, absent a Global Section 95 Election by the taxpayer, apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999:

- preamble of paragraph (*b*) of the definition "investment business" in subsection 95(1),
- clauses (*b*)(ii)(B) and (C), and the "postamble" of subparagraph (*b*)(ii), of the definition "investment business" in subsection 95(1),
- subclauses 95(2)(*a*)(ii)(A)(II) and (B)(II),

- clause 95(2)(*a*)(ii)(C);

- paragraphs 95(2)(*n*) to (*q*),

- the "preamble" of subsection 95(2.2),

- paragraph 95(2.2)(*b*), and

- subsections 95(2.21), (2.22) and (2.23);

(C) Amendments to section 95 of the Act that, absent a Global Section 95 Election by the taxpayer, apply to taxation years, of a foreign affiliate of a taxpayer, that begin after 1999:

- paragraph 95(2.1)(*c*), and

- subsection 95(2.41);

(D) Amendments to section 5907 of the Regulations that, absent a Global Section 95 Election by the taxpayer, apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date:

- paragraph (*b*) of the definition "earnings" in Regulation 5907(1),

- paragraph (*a*.1) of the definition "exempt earnings" in Regulation 5907(1),

- subparagraph (*d*)(ii) of the definition "exempt earnings" in Regulation 5907(1),

- the preamble, paragraphs (*a*.1) and (*c*), and the "postamble", of the definition "exempt loss" in Regulation 5907(1),

- subparagraph (*d*)(i) of the definition "net earnings" in Regulation 5907(1),

- subparagraph (*b*)(v) of the definition "taxable earnings" in Regulation 5907(1),

- subparagraph (*b*)(v) of the definition "taxable loss" in Regulation 5907(1), and

- paragraphs 5907(2.7)(*a*) and (*b*) of the Regulations.

If a Global Section 95 Election is made by a taxpayer, the amendments to the definitions "exempt earnings" and "exempt loss" in Regulation 5907(1) that implement the new concept of "qualifying member" will apply only for foreign affiliate taxation years that end after 1999. For more detail, see the commentary to the definitions "exempt earnings" and "exempt loss" in Regulation 5907(1).

Fresh Start Section 95 Election

This set of proposals contains a number of amendments to section 95 of the Act, and to section 5907 of the Regulations, that apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. However, where a taxpayer so elects in writing and files the election (referred to as the "Fresh Start Section 95 Election") with the Minister of National Revenue before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which these amendments are assented to, all of those amendments apply to taxation years of all foreign affiliates, of the taxpayer, that begin after 1994. Notwithstanding subsections 152(4) to (5) of the Act, the Minister of National Revenue can make any assessment of a taxpayer's tax, interest and penalties payable under the Act for any of those taxation years that begin before [Announcement Date + 1] that is necessary to take these amendments into account.

Note that the Global Section 95 Election and the Fresh Start Section 95 Election are separate elections.

The following amendments to the Act and to the Regulations are covered by the Fresh Start Section 95 Election package:

- the definition "taxable Canadian business" in subsection 95(1);

- paragraphs 95(2)(*j*.1) and (*j*.2) and 95(2)(*k*) to (*k*.6); and

- subsections 5907(2.9) and (2.91) of the Regulations.

(However, see the commentary to paragraph 95(2)(*k*) for additional information with respect to transitional provisions.)

Definitions

ITA
95(1)

Subsection 95(1) of the Act defines a number of terms for the purposes of subdivision i of Division B of Part I of the Act in connection with the taxation of resident shareholders of foreign affiliates.

"excluded property"

The definition "excluded property" is relevant for the purposes of computing the foreign accrual property income (FAPI) and the tax surpluses and deficits of a foreign affiliate of a taxpayer. Under the definition "foreign accrual property income" in subsection 95(1), capital gains and losses from the disposition of excluded property are disregarded in computing FAPI except in the circumstances set out in the description of B in that definition.

Paragraph (*a*) of the definition "excluded property" provides that any property used or held by the foreign affiliate principally for the purpose of gaining or producing income from an active business is excluded property under that definition. Paragraph (*a*) of the definition is amended to clarify that property does not meet the requirements of that paragraph unless the property is used or held by the foreign affiliate principally for the purpose of gaining or producing income from an active business that is carried on by it.

Paragraph (*b*) of the definition "excluded property" provides that shares owned by a foreign affiliate of a taxpayer in the capital stock of another foreign affiliate of the taxpayer are excluded property if all or substantially all of the property of the other foreign affiliate is excluded property. Paragraph (*b*) of the definition is amended to clarify that shares owned by a foreign affiliate of a taxpayer in the capital stock of another foreign affiliate of the taxpayer do not meet the requirements of that paragraph unless all or substantially all of the fair market value of the property of the other foreign affiliate is attributable to excluded property.

Paragraph (*c*) of the definition "excluded property" provides that an amount receivable is excluded property of a foreign affiliate of a taxpayer if the interest on the amount receivable is, or would be if interest were payable on it, income from an active business because of subparagraph 95(2)(*a*)(ii) of the Act. Paragraph (*c*) of the definition is amended to broaden the meaning of "excluded property" to include property all or substantially all of the income from which would be income from an active business because of amended paragraph 95(2)(*a*) if that paragraph were read without reference to subparagraph (v). For additional information, see the commentary to paragraph 95(2)(*a*).

New paragraph (*c*.1) is added to the definition "excluded property" to include property arising under or as a result of a written agreement that

- provides for the purchase, sale or exchange of currency, and
- can reasonably be considered to have been made by a foreign affiliate of a taxpayer to reduce the affiliate's risk, with respect to an amount that was receivable under a written agreement that relates to the sale of excluded property or with respect to an amount that was receivable and was property described in amended paragraph (*c*) of the definition, of fluctuations in the value of the currency in which the amount receivable was denominated.

New paragraph (*c*.1) of the definition "excluded property" will, for example, address a situation where the affiliate enters into an agreement (the "sale agreement"), relating to the sale of excluded property, in which the amount receivable under the sale agreement is denominated in a currency other than the affiliate's calculating currency, and then, in order to reduce the affiliate's risk of fluctuations in the value of the currency in which the amount receivable under the sale agreement is denominated, enters into a currency hedging agreement with respect to all or a portion of that amount receivable. In such a situation, new paragraph (*c*.1) ensures that the income or loss from that hedge receives the same income characterization as the income or loss from the property being hedged; i.e., the income or loss from that hedge is considered to be income or loss from the sale of excluded property.

New paragraphs (*a*), (*c*) and (*c*.1) of the definition "excluded property" apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that those paragraphs are part of the Global Section 95 Election package described at the beginning of the commentary to section 95.

New paragraph (*b*) of the definition "excluded property" applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

"foreign accrual property income"

The definition "foreign accrual property income" in subsection 95(1) of the Act is relevant for the purposes of section 91 of the Act and for the purposes of computing the tax surpluses and deficits of the foreign affiliate of a taxpayer. Section 91 of the Act provides rules for determining amounts that a taxpayer resident in Canada is to include in computing that taxpayer's income for a particular year as income from a share of a controlled foreign affiliate of that taxpayer.

The description of B in the definition "foreign accrual property income" in subsection 95(1) is amended to ensure that capital gains and losses from dispositions of excluded property are included in foreign accrual property income (FAPI) where subsection 88(3) of the Act applies in respect of the disposition. This amendment therefore ensures that FAPI reflects gains and losses that arise where shares of a foreign affiliate of a taxpayer are acquired by the taxpayer on the dissolution of another foreign affiliate of the taxpayer and the taxpayer chooses to step up the cost of those shares by electing under subsection 88(3) of the Act.

This amendment applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

"investment business"

The definition "investment business" in subsection 95(1) of the Act is relevant for the purposes of the definitions "income from property" and "foreign accrual property income" in that subsection.

Under the definition "investment business", the investment business of a foreign affiliate of a taxpayer means, in general, a business carried on by the affiliate the principal purpose of which is to derive income from property, income from the insurance or reinsurance of risks, income from the factoring of trade accounts receivable, or profits from the disposition of investment property, unless it is established that the business meets the requirements of paragraphs (*a*) and (*b*) of that definition.

Paragraph (*a*) of the definition "investment business" requires that the affiliate carry on a type of business described in that paragraph. That paragraph requires that the business be carried on principally with arm's length persons and be either

- carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated in the country in which the business is principally carried on (subparagraph (*a*)(i) of the definition), or

- the development of real estate for sale, the lending of money, the leasing or licensing of property or the insurance or reinsurance of risks (subparagraph (*a*)(ii) of the definition).

In general terms, paragraph (*b*) of the definition requires that the affiliate (or as described in the preamble to paragraph (*b*) of the definition, where the affiliate carries on the business as a member of a partnership (except where the affiliate is a "specified member" of the partnership)), the partnership

- employ more than 5 employees full time in the active conduct of the business (subparagraph (*b*)(i) of the definition), or

- employ the equivalent of more than 5 employees in the active conduct of the business, taking into account only services provided by the employees of the affiliate and services provided outside Canada by employees of

    - a corporation related to the affiliate (clause (*b*)(ii)(A) of the definition), or

- members of the partnership, other than a "specified member" of the partnership (clause (*b*)(ii)(B) of the definition).

The definition "investment business" is amended in the following ways.

First, subparagraph (*a*)(i) of definition is amended to refer to a business carried on by an affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of each country in which the business is carried on and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,
- of the country in which the business is principally carried on, or
- if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union.

Second, the "preamble" to paragraph (*b*) of the definition "investment business" is amended so that the concept of "member of a partnership (except where the affiliate is a specified member of the partnership)" is replaced by the concept of "qualifying member of a partnership".

Third, clause (*b*)(ii)(B) of the definition "investment business" is replaced by new clauses (*b*)(ii)(B) and (C) so that, in general terms, in determining whether the affiliate or the partnership employs the equivalent of more than 5 employees full time in the active conduct of the business, there is taken into account only services provided by the employees of the affiliate and services provided outside Canada by employees of

- a corporation related to the affiliate (clause (*b*)(ii)(A) of the definition), or
- where the affiliate carries on the business as a member of the partnership, a person who was a "qualifying member" of the partnership (clause (*b*)(ii)(B) of the definition), or
- where the affiliate carries on the business (other than as a member of the partnership), a corporation that was a "qualifying shareholder" of the affiliate (clause (*b*)(ii)(C) of the definition).

Fourth, the "postamble" to subparagraph (*b*)(ii) of the definition "investment business" is amended to reflect the addition of new clause (*b*)(ii)(C) of that definition.

The expression "qualifying member" is a newly introduced term and is defined in new paragraph 95(2)(*o*) for the purposes of subdivision i of Division B of Part I of the Act. That expression is, for the purposes of the Act generally, defined in amended subsection 248(1) of the Act as a person who would, at the relevant time, be determined to be a qualifying member of the partnership under paragraph 95(2)(*o*). For more information about the expression "qualifying member", see the commentary to paragraph 95(2)(*o*) and subsection 248(1).

The expression "qualifying shareholder" is also a newly introduced term and is defined in new paragraph 95(2)(*p*). For additional information, see the commentary to that paragraph.

The amendments to the "preamble" of paragraph (*b*), and to clause (*b*)(ii)(B), of the definition "investment business", in conjunction with the new definition "qualifying member", ensure that, in applying paragraph (*b*) of the definition "investment business", limited partners who are qualifying members of a limited partnership are treated in the same manner as general partners of general partnerships. These amendments also ensure that, even if the activities of the relevant partner do not meet the business activity requirements in new subparagraph 95(2)(*o*)(i), a partnership may qualify under the "preamble" to paragraph (*b*) of the definition "investment business" (or a partner may qualify under clause (*b*)(ii)(C) of that definition) if the relevant partner has an equity interest in the partnership that meets the criteria set out in new subparagraph 95(2)(*o*)(ii). For more detail, see the commentary to new paragraph 95(2)(*o*).

New clause (*b*)(ii)(C) of the definition "investment business", in conjunction with the new definition "qualifying shareholder", ensures that in the case where the affiliate carries on the business (other than as a member of the partnership), services that are rendered outside of Canada by a corporation that was a "qualifying shareholder" of the affiliate, and otherwise meet the conditions set out in paragraph (*b*) of the definition, may be taken into account in determining whether the "more than 5 employees full time" equivalency test in subparagraph (*b*)(ii) is met. For more detail, see the commentary to the definition "qualifying shareholder" in paragraph 95(2)(*p*).

Amended subparagraph (*a*)(i) of the definition "investment business" applies to taxation years, of a foreign affiliate of a taxpayer, that begin after 2001.

The amendments to the "preamble" of paragraph (*b*), and to clause (*b*)(ii)(B), of the definition "investment business" apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that these amendments are included in the Global Section 95 Election package described in the beginning of the commentary to section 95.

"relevant tax factor"

The definition "relevant tax factor" in subsection 95(1) of the Act is used in providing recognition for foreign taxes imposed on the earnings of a foreign affiliate or entity. The existing definition provides that the relevant tax factor for a corporation or a partnership all the resident members of which are corporations is the reciprocal of the basic corporate tax rate (i.e., 1/.38, or 2.63). The factor for individuals and other partnerships is 2.

As part of a series of amendments reflecting recent and planned reductions in income tax rates, the definition "relevant tax factor" is amended. The relevant tax factor for a corporation or a partnership all the resident members of which are corporations will take account of the "general rate reduction percentage" provided in section 123.4 of the Act. For example, if a corporation's taxation year is the calendar year, its relevant tax factor for 2003 will be 1/(.38 – .05), or 3.03.

Similarly, to take account of decreasing personal income tax rates, the relevant tax factor for individuals and other partnerships is increased to 2.2.

These amendments apply to the 2002 and subsequent taxation years.

"taxable Canadian business"

Subsection 95(1) of the Act is amended to add the new definition "taxable Canadian business". This expression is used in new paragraphs 95(2)(*j*.1), (*k*) and (*k*.2) of the Act. For more detail, see the commentaries to those paragraphs.

A "taxable Canadian business", at any time of a foreign affiliate of a taxpayer resident in Canada or of a partnership of which a foreign affiliate of a taxpayer resident in Canada is a member (which foreign affiliate or partnership is referred to in that definition as the "operator"), is a business the income from which, for the operator's taxation year or fiscal period that includes that time, is income in respect of which

- tax is payable under Part I of the Act by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership (paragraph (*a*) of the definition), and

- no exemption from tax under Part I of the Act may be claimed under a tax treaty (as defined in subsection 248(1)) by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership (paragraph (*b*) of the definition).

The amendment to add the new definition "taxable Canadian business" applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

Also note that the definition "tax treaty" in subsection 248(1) is applicable to the 1998 and subsequent taxation years. Accordingly, these amendments ensure, in effect, that, in applying the definition "taxable Canadian business" for the 1997 and prior taxation years of all foreign affiliates of the taxpayer in the case where a taxpayer has made a Fresh Start Section 95 Election, the reference in paragraph (*b*) of the definition "taxable Canadian business" to the expression "tax treaty" is to be read as a reference to a "comprehensive agreement or convention for the elimination of double taxation on income, between the Government of Canada and the government of another country, which has the force of law in Canada at that time".

Determination of Certain Components of Foreign Accrual Property Income

ITA
95(2)

Subsection 95(2) of the Act provides rules for determining the income, of a foreign affiliate of a taxpayer resident in Canada, from a particular source. A foreign affiliate is considered to have three sources of income – income from property, income from a business other than an active business and income from an active business. This sourcing is important since the affiliate's income from property and the affiliate's income from a business other than an active business are included in the foreign accrual property income (FAPI) of the affiliate. Where the affiliate is a controlled foreign affiliate of the taxpayer, the taxpayer's share of the affiliate's FAPI must be included, under section 91 of the Act, in the taxpayer's income for Canadian tax purposes whether or not the income is distributed. The income of a foreign affiliate of a taxpayer from an active business is included, under section 90 of the Act, in the taxpayer's income for Canadian tax purposes only when paid to the shareholder as a dividend.

ITA
95(2)(*a*)

Paragraph 95(2)(*a*) of the Act characterizes, in certain circumstances, amounts that would otherwise be income from property as income from an active business. More particularly, subparagraphs 95(2)(*a*)(i) to (iv) provide that particular income of a foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest throughout a taxation year of the affiliate, from sources in a country (other than Canada) that would otherwise be income from property of the affiliate for the year, will be included in computing the income from an active business of the affiliate for the year.

However, paragraph 95(2)(*a*) does not

- require amounts that would otherwise be "losses" from property of the affiliate to be included in computing the income from an active business of the affiliate, or

- require amounts that would otherwise be income or losses from property of the affiliate to be included in computing the "loss" from an active business of the affiliate.

Paragraph 95(2)(*a*) is amended so that throughout that paragraph, except clause 95(2)(*a*)(ii)(D) and (E), the word "income" is replaced with the words "income or loss". In general, these amendments to paragraph 95(2)(*a*) ensure that, provided that the conditions specified in that paragraph are satisfied,

- amounts that would otherwise be "losses" from property of the affiliate can be included in computing the income from an active business of the affiliate, and

- amounts that would otherwise be income or losses from property of the affiliate can be included in computing the "loss" from an active business of the affiliate.

These amendments to paragraph 95(2)(*a*) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

ITA
95(2)(*a*)(i)

In general terms, subparagraph 95(2)(*a*)(i) of the Act permits a particular foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest, to include, in its active business income, its property income that is derived by it from activities that can reasonably be considered to be directly related to active business activities carried on in a country (other than Canada) by a person that is

- any other non-resident corporation to which the particular affiliate and the taxpayer are related throughout the year (for convenience referred to as Case 1), or

- the taxpayer, where the taxpayer is a life insurance corporation resident in Canada throughout the year (for convenience referred to as Case 2)

where that property income would, if that person were a foreign affiliate of the taxpayer and the income were earned by it, be included in computing the active business income of that person.

Case 2 deals with the situation where a foreign branch of the taxpayer is a life insurance corporation resident in Canada and a payment is made by the taxpayer to foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest.

However, Case 2 would not apply where, for example, a particular wholly-owned Canadian subsidiary of the taxpayer is a life insurance corporation resident in Canada and a payment is made by a foreign branch of the Canadian subsidiary to a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest.

In order to address that concern, subclauses 95(2)(*a*)(i)(A)(II) and (B)(II) are amended to extend Case 2 to allow for the recharacterization of property income derived by a foreign affiliate of the taxpayer, in respect of which the taxpayer has a qualifying interest, from payments made to the particular affiliate by a life insurance corporation resident in Canada throughout the year and that is the taxpayer, a person who controls the taxpayer or a person controlled by the taxpayer.

The amendments to subclauses 95(2)(*a*)(i)(A)(II) and (B)(II) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

As noted in the opening commentary to paragraph 95(2)(*a*), amendments made to that paragraph ensure that, throughout subparagraph 95(2)(*a*)(i), the word "income" is replaced with the words "income or loss". For further detail on those amendments and on their coming-into-force provisions, refer to that commentary.

ITA
95(2)(*a*)(ii)

Subparagraph 95(2)(*a*)(ii) of the Act provides that income that would otherwise be income from property for a taxation year of a particular foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest, will be included in the particular affiliate's income from an active business for the year to the extent that the income is derived from amounts paid or payable, directly or indirectly, to the particular affiliate or a partnership of which it is a member

- by a non-resident corporation to which the particular affiliate and the taxpayer are related throughout the year or by a partnership of which the non-resident corporation is a member (other than where it is a specified member, as defined in subsection 248(1) of the Act, of the partnership at any time in a fiscal period of the partnership that ends in the year) to the extent that those amounts paid or payable are for expenditures (either an expenditure of a current nature or an expenditure in respect of which an allowance is claimed) that would, if the non-resident corporation or the partnership were a foreign affiliate of the taxpayer, be deductible in the year or a subsequent taxation year by it in computing the amounts prescribed to be its earnings or loss from an active business, other than an active business carried on in Canada (clause 95(2)(*a*)(ii)(A));

- by another foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the year or by a partnership of which the other foreign affiliate of the taxpayer is a member (other than where the other affiliate is a specified member of the partnership at any time in a fiscal period of the partnership that ends in the year) to the extent that those amounts paid or payable are for expenditures (either an expenditure of a current nature or an expenditure in respect of which an allowance is claimed) that are or would, if the partnership were a foreign affiliate of the taxpayer, be deductible in the year or a subsequent taxation year by the other affiliate or the partnership in computing the amounts prescribed to be its earnings or loss from an active business, other than an active business carried on in Canada (clause 95(2)(*a*)(ii)(B));

- by a partnership where the particular affiliate is a member of the partnership (other than where it is a "specified member" of the partnership at any time in a fiscal period of the partnership that ends in the year) to the extent that those amounts paid or payable are for expenditures (either an expenditure of a current nature or an expenditure in respect of which an allowance is claimed) that would, if the partnership were a foreign affiliate of the taxpayer, be deductible in the year or a subsequent taxation year in computing the amounts prescribed to be its earnings or loss from an active business carried on by it outside Canada (clause 95(2)(*a*)(ii)(C));

- by another foreign affiliate of the taxpayer that is related to the particular affiliate and the taxpayer throughout the year (the "second affiliate") pursuant to a legal obligation to pay interest on borrowed money used to acquire, or on an amount payable for the acquisition of, property where

  - the property is excluded property of the second affiliate that is shares of another foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the year (the "third affiliate"),

  - the second affiliate and the third affiliate are resident in, and subject to income taxation in, the same country, and

  - the amounts paid or payable are relevant in computing the liability for taxes of the members of a corporate group composed of the second affiliate and one or more other foreign affiliates of the taxpayer which are resident in, and not exempt from income taxation in, the same country as the second affiliate and in respect of which the taxpayer has a qualifying interest throughout the year (clause 95(2)(*a*)(ii)(D)); or

- by the taxpayer, where the taxpayer is a life insurance corporation resident in Canada, to the extent that those amounts paid or payable are for expenditures that are deductible in the year or a subsequent taxation year by the life insurance corporation resident in Canada in computing its income or loss from carrying on its insurance business outside Canada and not in Canada (clause 95(2)(*a*)(ii)(E)).

A foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest, will be precluded from using clauses 95(2)(*a*)(ii)(A), (B) and (C) if the relevant member of the partnership referred to in those clauses is a specified member of the partnership. Generally, a "specified member" of a partnership in a fiscal period of the partnership is defined in subsection 248(1) of the Act as being

- a member who was a limited partner (within the meaning assigned by subsection 96(2.4)) of the partnership at any time in the period, or
- a member who was neither
  - actively engaged in the business of the partnership (otherwise than in the financing of the business), nor
  - carrying on, other than as a member of a partnership, a similar business as that carried on by the partnership (otherwise than in the financing of the business),

throughout that part of the period that the business is ordinarily carried on and during which the member was a member of the partnership.

Subparagraph 95(2)(*a*)(ii) is amended in the following ways.

First, clauses 95(2)(*a*)(ii)(A) to (C) are amended so that the condition requiring the relevant member of the partnership to be a member of the partnership (otherwise than as a specified member of the partnership) is replaced by the condition requiring the relevant member to be a "qualifying member" of the partnership throughout each period, in the fiscal period of the partnership that ends in the year. The expression "qualifying member" is a new term. It is defined in new paragraph 95(2)(*o*) for the purposes of subdivision i of Division B of Part I of the Act, and, for the purpose of the Act generally, defined in subsection 248(1) as being a person that would at the relevant time be determined under paragraph 95(2)(*o*) to be a qualifying member of the partnership. For more detail on the definition "qualifying member", see the commentary to paragraph 95(2)(*o*) and subsection 248(1).

The amendments to clauses 95(2)(*a*)(ii)(A) to (C), in conjunction with the new definition "qualifying member", ensure that, in applying those clauses, limited partners of limited partnerships that are qualifying members are treated in the same manner as general partners of general partnerships. Those provisions also ensure that, even if the activities of the relevant person do not meet the business activity requirements in new subparagraph 95(2)(*o*)(i), a partnership may still qualify under clause 95(2)(*a*)(ii)(A), (B) or (C) if the relevant person has an equity interest in the partnership that meets the criteria set out in new subparagraph 95(2)(*o*)(ii). For more detail, see the commentary to new paragraph 95(2)(*o*).

Second, clause 95(2)(*a*)(ii)(D) is amended so that

- current subclause 95(2)(*a*)(ii)(D)(IV) is replaced by new subclauses 95(2)(*a*)(ii)(D)(IV) and (V), and
- current subclause 95(2)(*a*)(ii)(D)(V) is replaced by new subclause 95(2)(*a*)(ii)(D)(VI).

Under existing subclause 95(2)(*a*)(ii)(D)(IV), the "second affiliate" and the "third affiliate" must be resident in and subject to income taxation in the same country. Thus, each of those affiliates must itself be subject to income taxation in that country and cannot be a flow-through entity under the income tax laws of that country. Amended subclauses 95(2)(*a*)(ii)(D)(IV) and (V) are intended to accommodate the case where the second affiliate, the third affiliate, or both, are such a flow-through entity.

New subclause 95(2)(*a*)(ii)(D)(IV) requires that the second affiliate and the third affiliate be resident in the same country for each of their taxation years (each of which taxation years is referred to as a "relevant taxation year" of the second affiliate or of the third affiliate, as the case may be) that end in the year.

New subclause 95(2)(*a*)(ii)(D)(V) requires that, in respect of each of the second affiliate and the third affiliate for each relevant taxation year of that affiliate, either

- that affiliate be subject to income taxation in that country in that relevant taxation year (sub-subclause 95(2)(*a*)(ii)(D)(V)1.), or

- the members or shareholders of that affiliate at the end of that relevant taxation year be subject to income taxation in that country on, in aggregate, all or substantially all of the income of that affiliate for that relevant taxation year in their taxation years in which that relevant taxation year ends or would be so subject to income taxation in that country if that affiliate had income for that relevant taxation year and the income of those members or shareholders for their taxation years in which that relevant taxation year ends consisted only of their share of income of that affiliate for that relevant taxation year (sub-subclause 95(2)(*a*)(ii)(D)(V)2.).

Current subclause 95(2)(*a*)(ii)(D)(V) contains a requirement that the amounts paid or payable by the second affiliate to the particular affiliate must be relevant in computing the liability for income taxes in that country of a corporate group composed of the second affiliate and one or more other foreign affiliates of the taxpayer (the shares of which are excluded property) that are resident in, and subject to income taxation in, that country and in respect of which the taxpayer has a qualifying interest throughout the year.

New subclause 95(2)(*a*)(ii)(D)(VI), which replaces current subclause 95(2)(*a*)(ii)(D)(V), requires that the amounts paid or payable by the second affiliate to the particular affiliate must be relevant in computing the income for income tax purposes in that country

- of the members (each of which membersis referred to as a "group member") of a group of corporations, if the group is composed of the second affiliate and of one or more other foreign affiliates of the taxpayer (each of which other foreign affiliates is referred to as a "group affiliate"), the taxpayer has a qualifying interest in respect of each group affiliate throughout the year, the second affiliate and each group affiliate would (if the reference in subclauses 95(2)(*a*)(ii)(D)(IV) and (V) to "third affiliate" were read as a reference to "group affiliate") meet the requirements of those subclauses in the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of a group member, from a source, for a taxation year of that group member that ends in the year is attributable to incomes and losses from an active business, or

- of the second affiliate, if
  - the third affiliate meets the requirements of sub-subclause 95(2)(*a*)(ii)(D)(V)2. in each relevant taxation year of the third affiliate,
  - the taxpayer has a qualifying interest in respect of the third affiliate throughout the year, and
  - it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of the third affiliate, from a source, for a taxation year of the third affiliate that ends in the year is attributable to incomes and losses from an active business.

Third, as noted above, current clause 95(2)(*a*)(ii)(E) provides for the recharacterization of certain amounts paid or payable to the particular affiliate, where the payer is the taxpayer and the taxpayer is a life insurance corporation resident in Canada, to the extent that those amounts are for expenditures that are deductible in the year or a subsequent taxation year by the taxpayer in computing its income or loss from carrying on its insurance business outside Canada and not in Canada.

Clause 95(2)(*a*)(ii)(E) is amended to provide for recharacterization of certain amounts paid or payable to the particular affiliate, where the payer is a life insurance corporation that is resident in Canada and is the taxpayer, a person who controls the taxpayer or a person controlled by the taxpayer, to the extent that those amounts were for expenditures that are deductible in the year or in a subsequent taxation year by the life insurance corporation in computing its income or loss from carrying on its life insurance business outside Canada and are not deductible in the year or a subsequent taxation year in computing its income or loss from carrying on its life insurance business in Canada.

For additional detail, see the commentary to subclauses 95(2)(*a*)(i)(A)(II) and (B)(II).

Fourth, as noted in the opening commentary to paragraph 95(2)(*a*), the amendments to that paragraph ensure that, throughout subparagraph 95(2)(*a*)(ii), except clauses (D) and (E), the word "income" is replaced with the words "income or loss". For further detail on those amendments and on their coming-into-force provisions, see that commentary.

New subclauses 95(2)(*a*)(ii)(A)(II) and (B)(II) and new clause 95(2)(*a*)(ii)(C) apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

New subclauses 95(2)(*a*)(ii)(D)(IV) to (VI) and new clause 95(2)(*a*)(ii)(E) apply to taxation years of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*a*)(v) and (vi)

New subparagraph 95(2)(*a*)(v) of the Act ensures that, in computing the active business income or loss of a particular affiliate, there is to be included the income or loss from property derived by the particular affiliate from the disposition of excluded property that is not capital property of the particular affiliate. The amendment is consequential to the amendments made to the definition "excluded property" in subsection 95(1).

New subparagraph 95(2)(*a*)(vi) ensures that income or losses derived under or as a result of certain agreements which provide for the purchase, sale or exchange of currency are treated as active business income, and not as foreign accrual property income, where such agreements relate to currency exchange risks with respect to amounts included in active business income under paragraph 95(2)(*a*).

New subparagraphs 95(2)(*a*)(v) and (vi) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these subparagraphs are included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*a*.1)(i)

Paragraph 95(2)(*a*.1) of the Act includes in the income from a business other than an active business (and thus the foreign accrual property income (FAPI) of a foreign affiliate) of a taxpayer resident in Canada, the income of the affiliate from the sale of property (including the income derived from services as agent provided in relation to a purchase or sale of property) if

- it is reasonable to conclude that the cost to any person of the property (other than property that was manufactured, produced, grown, extracted or processed in Canada by the taxpayer or a person with which the taxpayer does not deal at arm's length in the course of carrying on a business in Canada and that was subsequently sold to non-resident persons other than the affiliate or to the affiliate for sale to non-resident persons) is relevant in computing the income from a business carried on by the taxpayer or a person resident in Canada that does not deal at arm's length with the taxpayer or is relevant in computing the income from a business carried on in Canada by a non-resident person with whom the taxpayer does not deal at arm's length (subparagraph 95(2)(*a*.1)(i)), and

- the property was not manufactured, produced, grown, extracted or processed in the country under whose laws the affiliate was formed (or continued) and exists and is governed, and the affiliate's business was principally carried on in that country (subparagraph 95(2)(*a*.1)(ii)).

The rule does not apply where more than 90% of the gross income of the affiliate from the sale of property is derived from sales of property (other than property that falls within the exclusions described above) to persons that deal at arm's length with the affiliate, which, for this purpose, includes a sale of property to a related non-resident corporation for sale by it to arm's length persons. Where the rule applies to the foreign affiliate of the taxpayer, the selling of the property is deemed to be a separate business other than an active business of the affiliate. Any income that pertains to or is incident to that business is also deemed to be income of the affiliate from a business other than an active business of the affiliate.

Subparagraph 95(2)(*a*.1)(i) is amended to replace the test in that paragraph with a test that can be summarized as follows: it is reasonable to conclude that the cost to any person of the property (other than property that is designated property and that was subsequently sold to non-resident persons other than the affiliate or to the affiliate for sale to non-resident persons) is relevant in computing the income from a business carried on by the taxpayer (or by a person resident in Canada that does not deal at arm's length with the taxpayer) or is relevant in computing the income from a business carried on in Canada by a non-resident person with whom the taxpayer does not deal at arm's length.

The definition "designated property" is provided in new subsection 95(3.1). Property is designated property if it is property the income from the sale of which is included in computing the income of a foreign affiliate of a taxpayer resident in Canada and meets one of the three tests set out in paragraphs (*a*), (*b*) and (*c*), respectively, of that definition.

Under the first test (paragraph (*a*) of the definition), property is designated property if it was manufactured, produced, grown, extracted or processed in Canada by the taxpayer, or by a person with whom the taxpayer does not deal at arm's length, in the course of carrying on a business in Canada.

Under the second test (paragraph (*b*) of the definition), property is designated property if it was acquired, in the course of carrying on a business in Canada, by a purchaser from a vendor if

- the purchaser is the taxpayer or is a person resident in Canada with whom the taxpayer does not deal at arm's length, and
- the vendor is a person
    - with whom the taxpayer deals at arm's length,
    - who is not a foreign affiliate of the taxpayer, and
    - who is not a foreign affiliate of a person resident in Canada with whom the taxpayer does not deal at arm's length.

Under the third test (paragraph (*c*) of the definition), property is designated property if it was acquired by a purchaser from a vendor if

- the purchaser is the taxpayer or is a person resident in Canada with whom the taxpayer does not deal at arm's length,
- the vendor is a foreign affiliate of
  - the taxpayer, or
  - a person resident in Canada with whom the taxpayer does not deal at arm's length, and
- the property was manufactured, produced, grown, extracted or processed in the country under whose laws the vendor is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, and in which the vendor's business is principally carried on.

The amendment to subparagraph 95(2)(*a*.1)(i) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Example 1

Facts:

1. *Canco is a corporation resident in Canada.*
2. *Forco is a controlled foreign affiliate of Canco.*
3. *XYZ is a corporation resident in Canada with whom Canco deals at arm's length.*
4. *Forco sells property to arm's length purchasers situated outside Canada. All the gross revenue and income of Forco is derived from the sale of property acquired from Canco. That property was acquired by Canco from XYZ and was manufactured in Canada by XYZ.*

Application of paragraph 95(2)(a.1)

Forco's income from the sale of the property that Forco had acquired from Canco would, because of existing paragraph 95(2)(a.1), be included in Forco's income from a business other than an active business and thus the FAPI of Forco. This is because existing subparagraph 95(2)(a.1)(i) exempts property manufactured in Canada only if it was manufactured by Canco or by a person with whom the Canco does not deal at arm's length. In this case, the manufacturer is XYZ, an arm's length corporation.

However, because of amended subparagraph 95(2)(a.1)(i) and paragraph (b) of the definition "designated property" in new subsection 95(3.1), Forco's income from the sale of the property acquired by Forco from Canco will not be recharacterized by paragraph 95(2)(a.1) as income from a business other than an active business.

Example 2

Facts:

1. Canco is a corporation resident in Canada.

2. FA1 is a controlled foreign affiliate of Canco that was formed, exists and is governed under the laws of foreign Country A. FA1's manufacturing business is principally carried on in that country. The gross revenue and income of FA1 is derived from the sale, to Canco, of the property that FA1 manufactures.

3. FA2 is a controlled foreign affiliate of Canco. FA2 was formed, exists and is governed under the laws of foreign Country B. FA2's business is principally carried on in that country. FA2 purchases, from Canco, property that was manufactured in Country A by FA1. FA2 sells the property to purchasers outside of Canada.

Application of paragraph 95(2)(a.1)

The income from the sale of the property acquired by FA2 from Canco would, because of existing paragraph 95(2)(a.1), be included in FA2's income from a business other than an active *business and thus the FAPI of FA2. This is because existing subparagraph 95(2)(a.1)(i) exempts property manufactured, produced, grown, extracted or processed in Canada only where the property was manufactured, produced, grown, extracted or processed in Canada by Canco, or by a person with whom Canco does not deal at arm's length. In this case, the property was manufactured outside of Canada by FA1.*

However, because of amended subparagraph 95(2)(a.1)(i) and paragraph (c) of the definition of "designated property" in new subsection 95(3.1), FA2's income from the sale of the property acquired by FA2 from Canco will not be recharacterized by paragraph 95(2)(a.1) as income from a business other than an active business.

ITA
95(2)(*b*)

Paragraph 95(2)(*b*) of the Act provides that if, in any of the specified circumstances referred to in that paragraph, any particular controlled foreign affiliate of a taxpayer provides services (or an undertaking to provide services), the provision of those services (or the undertaking) is deemed to be a separate business, other than an active business, carried on by the particular affiliate and any income from that business or that pertains to or is incident to that business is deemed to be income from a business other than an active business. Such income is therefore included in computing the particular affiliate's foreign accrual property income (FAPI).

The "preamble" of paragraph 95(2)(*b*) is amended to provide that if, in any of the circumstances referred to in that paragraph, any particular foreign affiliate of a taxpayer (whether or not that affiliate is a controlled foreign affiliate of the taxpayer) provides services (or an undertaking to provide services), the provision of those services (or the undertaking) is deemed to be a separate business, other than an active business, carried on by the particular affiliate and any income from that business or that pertains to or is incident to that business is deemed to be income from a business other than an active business.

The amendment to the preamble of paragraph 95(2)(*b*) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

ITA
95(2)(*b*)(i)(C)

New clause 95(2)(*b*)(i)(C) provides that, if a particular affiliate provides services (or an undertaking to provide services) and the amount paid or payable in consideration for those services (or the undertaking) is deductible, or can reasonably be considered to relate to an amount that is deductible, in computing the FAPI of a controlled foreign affiliate of

- any person in relation to whom the particular affiliate is a controlled foreign affiliate, or

- a person related to any such person,

the provision of those services (or the undertaking) is deemed to be a separate business, other than an active business, carried on by the particular affiliate and any income from that business or that pertains to or is incident to that business is included in computing the particular affiliate's FAPI.

For example, this amendment provides that within a corporate group, income that would otherwise be income from an investment business (and therefore included in computing FAPI) of one foreign corporation in the group cannot be converted to active business income by the payment of fees to another foreign corporation in the group for services rendered to that investment business.

New clause 95(2)(*b*)(i)(C) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

ITA
95(2)(*d*.1)

Paragraph 95(2)(*d*.1) of the Act provides for the rollover of capital property on a foreign merger where certain conditions have been met. One of these conditions (referred to as the "non-recognition condition") is that no gain or loss was recognized, under the income tax law of the country in which the predecessor foreign corporations were resident, in respect of any capital property of a predecessor foreign corporation that became capital property of the new foreign corporation in the course of the foreign merger.

Paragraph 95(2)(*d*.1) is amended to provide for the rollover of property (including, but not restricted to capital property) on a foreign merger where certain conditions have been met. In addition, the non-recognition condition is amended to require that no income, gain or loss was recognized, under the income tax law of the country in which the predecessor foreign corporations were resident, in respect of any property of a predecessor foreign corporation that became property of the new foreign corporation in the course of the foreign merger.

New paragraph 95(2)(*d*.1) applies to foreign mergers that occur after Announcement Date.

ITA
95(2)(*e*.1)

Paragraph 95(2)(*e*.1) provides for the rollover of capital property on a liquidation and a dissolution of a foreign affiliate of a taxpayer where certain conditions have been met. One of these conditions (referred to as the "non-recognition condition") is that no gain or loss was recognized, under the income tax law of the country in which the disposing affiliate was resident, by the disposing affiliate in respect of any property of the disposing affiliate that was distributed by the disposing affiliate in the course of the liquidation to another foreign affiliate, of the taxpayer, resident in that country.

Paragraph 95(2)(*e*.1) is amended to provide for the rollover of property (including, but not restricted to, capital property) on a liquidation and a dissolution of a foreign affiliate of a taxpayer where certain conditions have been met. In addition, the non-recognition condition is amended to require that no income, gain or loss was recognized, under the income tax law of the country in which the disposing affiliate was resident, by the disposing affiliate in respect of any property of the disposing affiliate that was distributed by the disposing affiliate in the course of the liquidation and dissolution to another foreign affiliate of the taxpayer. The non-recognition condition no longer requires that this other foreign affiliate be resident in the same country as the disposing affiliate.

New paragraph 95(2)(*e*.1) applies to liquidations that begin after Announcement Date.

ITA
95(2)(*f*)

Paragraph 95(2)(*f*) sets out rules for computing the taxable capital gain and allowable capital loss of a foreign affiliate of a taxpayer on a disposition of property.

The rules in paragraph 95(2)(*f*) address the computation of a gain or loss on a disposition of property whether the disposition is made by the affiliate itself or by a flow-through entity (e.g., a partnership) in which the affiliate has an interest. The "preamble" to paragraph 95(2)(*f*) refers to a "disposition of property" and thus the scope of that paragraph is not limited to dispositions where the disposition is made by the affiliate itself.

That paragraph also contains a relieving provision, which is set out in the portion of that paragraph that appears between subparagraph (ii) and (iii) of that paragraph, that provides that, in computing any such gain or loss from the disposition of property owned by the affiliate at the last time that the affiliate became a foreign affiliate of the taxpayer, there not be included such portion of the gain or loss, as the case may be, as can reasonably be considered to have accrued during the period that the affiliate was not a foreign affiliate of the taxpayer or of a person specified in any of subparagraphs 95(2)(*f*)(iv) to (vii).

Paragraph 95(2)(*f*) is amended in the following ways.

First, the "preamble" is amended to clarify that the rules in that paragraph also apply for computing the foreign affiliate's capital gains and capital losses and that they apply to the affiliate in respect of a taxpayer.

This amendment to paragraph 95(2)(*f*) will, for example, preclude the recognition of capital gains or capital losses from the disposition of property to the extent that the gain or loss can reasonably be considered to have accrued during the period that the affiliate was not a foreign affiliate of the taxpayer or of another specified person. This is relevant for the purpose of computing the tax surpluses and deficits of the affiliate in respect of the taxpayer and computing the affiliate's foreign accrual property income or loss in respect of the taxpayer.

Second, the "preamble" is amended so that the words "disposition of property" are replaced with the words "disposition of property by a person or partnership". This amendment is consequential to the amendment made to the "mid-amble" of paragraph 95(2)(*f*).

Third, the "mid-amble" of paragraph 95(2)(*f*) is amended to replace the words "owned by the affiliate" with the words "owned by the person or partnership". This amendment addresses situations where the property disposed of was owned by a flow-through entity in which the affiliate has an interest. This amendment ensures that, in computing a gain or loss from the disposition of property owned by the person or partnership at the time the affiliate last became a foreign affiliate of the taxpayer, no portion of the gain or loss, as the case may be, that can reasonably be considered to have accrued during the period that the affiliate was not a foreign affiliate of the taxpayer or of a person specified in subparagraphs 95(2)(*f*)(v), (vi) and (vii) is included.

In connection with the application of paragraph 95(2)(*f*), see also the commentary to new subsections 95(2.21), (2.22) and (2.23).

The amendments to the "preamble" of paragraph 95(2)(*f*) apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999.

The amendment to the "mid-amble" of paragraph 95(2)(*f*) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*f*.1)

New paragraph 95(2)(*f*.1) of the Act ensures that, in computing the income or loss from property of a foreign affiliate in respect of a taxpayer,

- the income or loss is computed in respect of the taxpayer in Canadian currency and in accordance with Part I of the Act as though the affiliate were resident in Canada, and

- the income or loss does not include any income or loss that can reasonably be considered to have been realized or to have accrued during any period throughout which the affiliate was not a foreign affiliate of the taxpayer or of another person described in any of subparagraphs 95(2)(*f*)(iii) to (vii) of the Act.

This amendment applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*f*.2)

New paragraph 95(2)(*f*.2) provides that the income or loss of a foreign affiliate of a taxpayer arising from the disposition of excluded property which is not capital property (other than a disposition of capital property or property to which paragraph 95(2)(*c*), (*d*) or (*e*) or subsection 88(3) of the Act applies) is to be computed in the currency of the country in which the foreign affiliate is resident or in another currency that is reasonable in the circumstances. (The expression "excluded property" is defined in subsection 95(1).) The calculations provided for in new paragraph 95(2)(*f*.2) are comparable to those provided for in the rule in subsection 5907(6) of the Regulations. (The rule in that subsection applies with respect to the computation of the surpluses and deficits of a foreign affiliate in Part LIX of the Regulations.)

This amendment applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*g*.3)

Paragraph 95(2)(*g*) provides that where, because of a fluctuation in the value of the currency of a country other than Canada relative to the value of Canadian currency, a foreign affiliate of a taxpayer in respect of which the taxpayer has a qualifying interest throughout a taxation year of the affiliate has earned income or incurred a loss or realized a capital gain or a capital loss in the year, in reference to certain debt and share transactions of the affiliate, the income, gain or loss, as the case may be, is nil.

New paragraph 95(2)(*g*.3) deals with foreign currency hedging agreements. In general terms, that paragraph provides that a foreign currency income, gain or loss derived under or as a result of an agreement that provides for the purchase, sale or exchange of currency where the agreement can reasonably be considered to have been made by a foreign affiliate of a taxpayer to reduce the affiliate's risk (with respect to property, any particular income, gain or loss determined in reference to which is deemed by paragraph 95(2)(*g*) to be nil) of fluctuations in the value of currency is, to the extent of the absolute value of the particular income, gain or loss, deemed to be nil. This amendment ensures that income, a gain or a loss from a hedge is deemed to be nil if the hedged income, loss or gain is deemed to be nil.

This amendment applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*h*)

New paragraph 95(2)(*h*) ensures that foreign exchange gains and losses of a foreign affiliate of a taxpayer determined under subsection 39(2) in respect of excluded property (as defined in subsection 95(1) of the Act) are computed separately from the affiliate's foreign exchange gains and losses in respect of other property. This amendment facilitates the computation of the foreign accrual property income and the tax surpluses and deficits of a foreign affiliate of a taxpayer.

This amendment applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*i*)

Paragraph 95(2)(*i*) provides a rule under which certain gains or losses (determined in accordance with subsection 39(2) of the Act) of a foreign affiliate of a taxpayer are deemed to be a gain or loss, as the case may be, from the disposition of an excluded property (as defined in subsection 95(1) of the Act) and are therefore not included in computing the affiliate's foreign accrual property income. Under this paragraph, the gain or loss that is eligible for this treatment is a gain or loss of the affiliate from the settlement or extinguishment of a debt that related at all times to the acquisition of an excluded property. This paragraph is amended in three aspects.

First, it is amended so that the gain or loss from the settlement or extinguishment of a debt is eligible for this treatment if all or substantially all of the proceeds from the debt were used at all times to acquire excluded property or to earn income from an active business or a combination of those uses.

Second, it is amended to ensure that a gain or loss of an affiliate is also eligible for this treatment if it is a gain or loss derived under or as a result of an agreement that provides for the purchase, sale or exchange of currency, where the agreement can reasonably be considered to have been made by the affiliate to reduce its risk (with respect to the debt) of fluctuations in the value of the currency in which the debt was denominated.

Third, it is amended so that its "preamble" contains a specific reference to gains and losses, determined in accordance with subsection 39(2) of the Act, which provides the general rules for the calculation of foreign currency gains and losses.

These amendments to paragraph 95(2)(*i*) clarify the relationship between paragraph 95(2)(*f*) and subsection 39(2) of the Act and expand the scope of paragraph 95(2)(*i*) so that it applies more broadly to indebtedness used to fund active business operations. It also applies to certain foreign currency hedging agreements which are related to that indebtedness.

These amendments to paragraph 95(2)(*i*) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

Note that these amendments are part of the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*j*.1) and (*j*.2)

Subsection 95(2) is amended to add new paragraphs 95(2)(*j*.1) and (*j*.2).

New paragraph 95(2)(*j*.1) provides that new paragraph 95(2)(*j*.2) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer and in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member of the partnership (which foreign affiliate or partnership is referred to as the "operator" and which particular taxation year or particular fiscal period is referred to as the "specified taxation year") if in the specified taxation year

- the operator carries on a business (referred to as a "foreign business"),
- the foreign business includes the insuring of risks,
- the foreign business is not, at any time, a "taxable Canadian business" (as newly defined in subsection 95(1) of the Act);
- the foreign business is
  - an investment business, or
  - a business the activities of which include activities deemed by paragraph 95(2)(*a*.2) or (*b*) to be a separate business, other than an active business, carried on by the affiliate; and
- the operator would, if it were a corporation carrying on the foreign business in Canada, be required by law to report to the Superintendent of Financial Institutions or a similar authority of a province in respect of the foreign business.

New paragraph 95(2)(*j*.2) provides that in computing an affiliate's foreign accrual property income in respect of a taxpayer from the foreign business for the specified taxation year and each subsequent taxation year or fiscal period in which the foreign business is carried on by the operator

- the operator is deemed to have been required by law to report to and to have been subject to the supervision of the particular regulatory authority, and

- if the operator is a life insurer and the foreign business is a life insurance business, the life insurance policies issued in the conduct of that business are deemed to be life insurance policies in Canada.

For information about the new definition "taxable Canadian business", see the commentary to subsection 95(1).

New paragraphs 95(2)(*j*.1) and (*j*.2) ensure that the operator is eligible to claim certain policy reserves in connection with an insurance business.

These new paragraphs apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

Note that, absent a Fresh Start Section 95 Election by a taxpayer, subsection 1402(2) of the Regulations (which was repealed by P.C. 1999-1154, SOR/99-269, dated June 23, 1999) ensures, if the affiliate itself is the operator, that a result similar to the result afforded by new paragraphs 95(2)(*j*.1) and (*j*.2) is afforded for the 1995 and prior taxation years of a foreign affiliate of the taxpayer.

ITA
95(2)(*k*) and (*k*.1)

Paragraph 95(2)(*k*) provides fresh start rules that, in general terms, are triggered if there is one of two types of changes to the business activities of a foreign affiliate of a taxpayer, namely:

- in a particular taxation year, the affiliate carries on an investment business outside Canada and, in the preceding taxation year, that business was not an investment business (as defined in subsection 95(1) of the Act) of the affiliate, or

- in a particular taxation year, the affiliate is deemed by paragraph 95(2)(*a*.1), (*a*.2), (*a*.3) or (*a*.4) to carry on a separate business, other than an active business, and was not deemed by that paragraph to be carrying on that separate business in the preceding taxation year.

Paragraph 95(2)(*k*) refers to that investment business or that separate business as the "foreign business".

The fresh start rules set out in paragraph 95(2)(*k*) also apply where an affiliate begins to carry on a particular business in the particular year and the particular business was an investment business (or was comprised of activities deemed by paragraph 95(2)(*a*.1), (*a*.2), (*a*.3) or (*a*.4) to be a separate business, other than an active business, carried on by the affiliate).

These fresh start rules apply for the purpose of computing an affiliate's foreign accrual property income (FAPI) in respect of a taxpayer from a foreign business for a particular taxation year of the affiliate and for each subsequent taxation year in which the foreign business is considered to be carried on. In general terms, the fresh start rules provide for the following in computing the affiliate's FAPI in respect of the taxpayer from the foreign business for those years:

- The affiliate is deemed to have begun to carry on the foreign business in Canada at the later of the time the particular taxation year began and the time the affiliate began carrying on the foreign business. The affiliate is also deemed to have carried on the foreign business in Canada throughout that part of the particular taxation year and each subsequent taxation year in which the foreign business is considered to be carried on by the affiliate.

- Where the foreign business is a business in respect of which the affiliate would, if the foreign business were carried on in Canada, be required by law to report to a regulating authority such as the federal Superintendent of Financial Institutions or a similar authority of a province, the affiliate is deemed to have been subject to the supervision of such a regulating authority.

- Paragraphs 138(11.91)(*c*) to (*f*) of the Act apply to the affiliate in respect of the foreign business as if the affiliate were the insurer referred to in subsection 138(11.91), the particular taxation year were the particular year referred to in those paragraphs and the foreign business were the business of the insurer referred to in those paragraphs.

The fresh start rules in subparagraph 95(2)(*k*) ensure that the income of the affiliate from the foreign business is calculated using Canadian tax rules. For example, the rule deeming the affiliate to be subject to the supervision of a regulating authority permits the affiliate to claim certain reserves in respect of insurance policies in connection with the foreign business. As well, there is a deemed disposition and reacquisition of property used or held in the foreign business immediately before the beginning of the particular taxation year. The fresh start rules ensure that income or losses accruing in prior periods do not enter into the income calculations for the foreign business in the particular taxation year or in subsequent taxation years.

A number of amendments are made to these fresh start rules. Note that paragraph 95(2)(*k*) is being divided into amended paragraph 95(2)(*k*) and new paragraph 95(2)(*k*.1). Amended paragraph 95(2)(*k*) defines the circumstances to which the fresh start rules apply, and new paragraph 95(2)(*k*.1) contains the substantive provisions of the fresh start rules.

Amended paragraph 95(2)(*k*) provides that new paragraph 95(2)(*k*.1) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer or in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member of the partnership (which foreign affiliate or partnership is referred to as the "operator" and which particular taxation year or particular fiscal period is referred to as the "specified taxation year") if the following four conditions are met:

- in the specified taxation year, the operator carries on a business (referred to in amended paragraph 95(2)(k) and, subject to new paragraph 95(2)(*k*.6), in new paragraph 95(2)(*k*.1), as a "foreign business"),

- the foreign business is not, at any time in the specified taxation year, a taxable Canadian business,

- in the specified taxation year, the foreign business is[1]
    - an investment business (clause 95(2)(*k*)(iii)(A)),
    - a business the activities of which include activities deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the affiliate (clause 95(2)(*k*)(iii)(B), or
    - a business the income from which is included by paragraph 95(2)(*l*) in computing the affiliate's income from property for the specified taxation year (clause 95(2)(*k*)(iii)(C)),

and

- in the preceding taxation year or fiscal period,
    - the operator carried on the foreign business,
    - the foreign business was not, at any time in that preceding taxation year, a "taxable Canadian business", and
    - the foreign business was not described in any of clauses 95(2)(*k*)(iii)(A), (B) or (C).

In connection with the first of these conditions, see the commentary to new subparagraph 95(2)(*k*.6).

New paragraph 95(2)(*k*.1) provides that, in computing the affiliate's foreign accrual property income in respect of the taxpayer from the foreign business for the specified taxation year and each subsequent taxation year or fiscal period in which the foreign business is carried on by the operator,

- the operator is deemed
    - to have begun to carry on the foreign business in Canada at the beginning of the specified taxation year, and

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[1] Subparagraph 95(2)(*k*)(iii)

  - to carry on the foreign business in Canada throughout that part of the specified taxation year, and of each of those subsequent taxation years or fiscal periods, in which the foreign business is carried on by the operator,

- if the operator would be required by law to report to the Superintendent of Financial Institutions or a similar authority of a province in respect of the foreign business if the operator were a corporation carrying on the foreign business in Canada,

  - the operator is deemed to have been required by law to report to and to have been subject to the supervision of such regulating authority, and

  - if the operator is a life insurer and the foreign business is a life insurance business, the life insurance policies issued in the conduct of that business are deemed to be life insurance policies in Canada, and

- paragraphs 138(11.91)(*c*) to (*e*) of the Act apply to the operator for the specified taxation year in respect of the foreign business as if

  - the operator were the insurer referred to in subsection 138(11.91),

  - the specified taxation year of the operator were the particular taxation year of the insurer referred to in that subsection,

  - the foreign business of the operator were the business of the insurer referred to in that subsection, and

  - the reference in paragraph 138(11.91)(*e*) to "designated insurance property in respect of the business" were read as a reference to "used or held by it in the particular taxation year in the course of carrying on the insurance business".

In general terms, the amendments to paragraph 95(2)(*k*) can be summarized as follows:

First, the amendments ensure that the fresh start rules apply not only if the particular business is carried on by a foreign affiliate of a taxpayer, but also if the particular business is carried on by a partnership of which a foreign affiliate of a taxpayer is a member. These amendments ensure, in the case of partnerships, that the fresh start rules will work on the basis of fiscal periods of the partnership and will therefore be relevant in the computation of the affiliate's foreign accrual property income for the affiliate's taxation year that includes a fiscal period to which the fresh start rules apply. In amended paragraph 95(2)(*k*) and new paragraph 95(2)(*k*.1), the expression "operator" refers to the affiliate (if the affiliate directly carries on the particular business) or to the partnership (if the affiliate carries on the particular business through the partnership).

Second, the amendments ensure that the fresh start rules are no longer triggered if the operator begins to carry on the particular business in the specified taxation year and did not carry on the particular business in the preceding taxation year. However, it is possible that, in such a situation, new paragraphs 95(2)(*j*.1) and (*j*.2) may apply. For further detail, see the commentary to new paragraphs 95(2)(*j*.1) and (*j*.2).

Third, the amendments ensure that the type of change in business activities that triggers the fresh start rules is a change that meets the following conditions:

- in the specified taxation year, the operator carries on a business (the "foreign business"),
- in the specified taxation year, the foreign business is
  - an investment business,
  - a business whose activities include activities deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business (other than an active business) carried on by the affiliate, or
  - a business the income from which is included by paragraph 95(2)(*l*) in computing the affiliate's income from property for the specified taxation year,
- in the preceding taxation year or fiscal period, the operator carried on the foreign business, and
- in that preceding taxation year or fiscal period, the foreign business was not described in any of clauses 95(2)(*k*)(iii)(A), (B) or (C).

Fourth, new paragraph 95(2)(*k*.1) provides that, in order for the fresh start rules to be triggered, the foreign business of the operator

- cannot, at any time in the specified taxation year, be a taxable Canadian business of the operator, and
- cannot, at any time in the preceding taxation year or fiscal period, have been a taxable Canadian business of the operator.

Generally, under the new definition "taxable Canadian business", a taxable Canadian business at any time of a foreign affiliate of a taxpayer resident in Canada or of a partnership of which a foreign affiliate of a taxpayer resident in Canada is a member (which foreign affiliate or partnership is referred to in the definition as the "operator") means a business the income from which, for the operator's taxation year or fiscal period that includes that time, is income in respect of which

- tax is payable under Part I of the Act by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership, and
- no exemption from tax under Part I of the Act may be claimed under a tax treaty by the operator or, where the operator is the partnership, by the foreign affiliate of the taxpayer that is a member of the partnership.

For more detail, see the commentary to the new definition "taxable Canadian business" in subsection 95(1) of the Act.

Fifth, new paragraph 95(2)(*k*.1) provides that life insurance policies issued by a foreign business of an affiliate in the conduct of that business are deemed to be life insurance policies in Canada if

- the operator would be required by law to report to the Superintendent of Financial Institutions or to a similar authority of a province in respect of the foreign business if the operator were a corporation carrying on the foreign business,
- the foreign business is a life insurance business, and
- the operator is a life insurer.

This new rule ensures that the operator is eligible to claim certain policy reserves in connection with the life insurance business.

Sixth, new paragraph 95(2)(*k*.1) makes it clear that, in applying paragraph 138(11.91)(*e*) of the Act to the fresh start rules, the reference in paragraph 138(11.91)(*e*) to "designated insurance property in respect of the business" is to be read as a reference to "property used or held by the insurer in the particular taxation year in the course of carrying on the insurance business".

Seventh, consequential to the repeal of paragraph 138(11.91)(*f*) of the Act, the reference, in the fresh start rules, to "paragraphs 138(11.91)(*c*) to (*f*)" is changed to read "paragraphs 138(11.91)(*c*) to (*e*)". For more detail, see the commentary to subsection 138(11.91).

New paragraphs 95(2)(*k*) and (*k*.1) apply to taxation years of a foreign affiliate of a taxpayer that begin after Announcement Date. Note that these amendments are included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

Also note that this set of amendments provides that, except where the taxpayer makes such a Fresh Start Section 95 Election, existing subparagraph 95(2)(*k*)(iv) of the Act is amended, applicable to taxation years that end after 1999 and begin before [Announcement Date + 1], to add a rule which provides that life insurance policies issued by a foreign business of an affiliate in the conduct of that business are deemed to be life insurance policies in Canada if

- the foreign business of the affiliate is a business in respect of which, if the foreign business were carried on in Canada, the affiliate would be required by law to report to a regulating authority in Canada such as the Superintendent of Financial Institutions or a similar authority of a province,
- the foreign business is a life insurance business, and
- the affiliate is a life insurer.

Accordingly, the affiliate would, for those taxation years, be eligible to claim certain policy reserves in connection with the life insurance business and not just reserves in connection with non-life insurance business.

Example

Facts

Forco, a wholly-owned foreign affiliate of Canco, is deemed to carry on an investment business. The principal purpose of Forco's business is to derive income from trading or dealing in securities. The particular taxation year of Forco in respect of which paragraphs 95(2)(k) and (k.1) apply to the investment business is its taxation year ended December 31, 1995 (its "1995 taxation year"). Forco had acquired the securities for $10 million. The fair market value of the securities was $12 million at the end of its taxation year that ended on December 31, 1994 (its "1994 taxation year"). Assume, for the purposes of this example, that Canco has made a valid Fresh Start Section 95 Election.

Application of paragraphs 95(2)(k) and (k.1)

Forco is deemed to have, at the end of its 1994 taxation year, disposed of all the securities used or held by it in respect of the investment business. Under subsection 5907(2.9) of the Regulations, for the purpose of computing Forco's surplus accounts at the end of its 1994 taxation year there would be added to "earnings" the amount of $2 million (i.e., $12 million minus $10 million). Following the deemed reacquisition of the securities at the beginning of its 1995 taxation year, Forco would have $12 million as the cost of its securities for the purposes of computing its income from the investment business. For additional detail, refer to the commentary to subsection 5907(2.9) of the Regulations.

ITA
95(2)(*k*.2) and (*k*.3)

New paragraphs 95(2)(*k*.2) and (*k*.3) operate together and, in general terms, provide for fresh start rules that are triggered if a business carried on that is not an active business of a foreign affiliate of a taxpayer (or a business of a partnership of which the affiliate is a member) becomes, in a particular taxation year of the affiliate or in a particular fiscal period of the partnership (as the case may be), an active business. These fresh start rules apply in computing the affiliate's foreign accrual property income (FAPI) in respect of the taxpayer from that business for the preceding taxation year or fiscal period.

Paragraph 95(2)(*k*.2) provides that paragraph 95(2)(*k*.3) applies in respect of a particular taxation year of a foreign affiliate of a taxpayer or in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member of the partnership (which foreign affiliate or partnership is referred to as the "operator" and which particular taxation year or particular fiscal period is referred to as the "specified taxation year") if the following four conditions are met:

- in the preceding taxation year or fiscal period, the operator carried on a business (which is referred to in paragraph 95(2)(k.2) and, subject to paragraph (*k*.6), in paragraph 95(2)(*k*.3), as the "foreign business"),

- the foreign business was not, at any time in that preceding taxation year or fiscal period, a taxable Canadian business,

- in that preceding taxation year or fiscal period, the foreign business was[2]

    - an investment business (clause 95(2)(*k*.2)(iii)(A)),

    - a business whose activities included activities deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the affiliate (clause 95(2)(*k*.2)(iii)(B)), or

    - a business the income from which is included by paragraph 95(2)(*l*) in computing the affiliate's income from property for that preceding taxation year or fiscal period (clause 95(2)(*k*.2)(iii)(C)),

and

- either

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[2] Subparagraph 95(2)(*k*.2)(iii)

  - at any time in the specified taxation year the operator carries on the foreign business, and the foreign business is an active business that is not a taxable Canadian business, or

  - at no time in the specified taxation year does the operator carry on the foreign business.

In connection with the first of these four conditions, see the commentary on new subparagraph 95(2)(*k*.6).

For detail on the new definition "taxable Canadian business", see the commentary to subsection 95(1) of the Act.

The fresh start rules in paragraph 95(2)(*k*.3) provide that, in computing the affiliate's FAPI in respect of the taxpayer from the foreign business for that preceding taxation year or fiscal period,

- the operator is deemed to have ceased to carry on the foreign business in Canada at the beginning of the specified taxation year, and

- paragraphs 138(11.91)(*c*) to (*e*) of the Act apply to the operator for the specified taxation year in respect of the foreign business as if

  - the operator were the "insurer" referred to in subsection 138(11.91),

  - the specified taxation year of the operator were the "particular taxation year" of the insurer referred to in that subsection,

  - the foreign business of the operator were the business of the insurer referred to in that subsection, and

  - the reference in paragraph 138(11.91)(*e*) to "designated insurance property in respect of the business" were read as a reference to property used or held by the insurer in the particular taxation year in the course of carrying on the insurance business.

Paragraphs 95(2)(*k*.2) and (*k*.3) ensure that, if a foreign business that is an active business in the specified taxation year was not an active business in the immediately preceding taxation year or fiscal period, as the case may be, any accrued gains will be included in computing the FAPI of the affiliate in that preceding taxation year or fiscal period. The active business income of the affiliate will reflect income, gains and losses accruing in the specified taxation year and in subsequent taxation years or fiscal periods, as the case may be. The reference, in subsection 95(2)(*k*.3), to paragraphs 138(11.91)(*c*) to (*e*), ensures that, immediately before the beginning of the specified taxation year, there is a deemed disposition and deemed reacquisition of property used or held in the foreign business.

New paragraphs 95(2)(*k*.2) and (*k*.3) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these paragraphs are part of the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

Example

Facts

Forco, a wholly-owned foreign affiliate of Canco, carried on a particular business that was an active business throughout its taxation year that ended December 31, 1997. Forco is resident in a country that is a designated treaty country for the purposes of Part LIX of the Regulations. In its taxation year that ended December 31, 1996 (its "1996 taxation year"), Forco carried on activities that were deemed by paragraph 95(2)(a.1) to be a separate business other than an active business.

At the end of its 1996 taxation year, Forco owned capital property with a cost amount of $6 million, and inventory with a cost amount of $2 million, that was property used or held in the course of carrying on this business. At the end of that taxation year, the fair market value of Forco's capital property was $10 million and the fair market value of its inventory was $4 million. Assume, for the purposes of this example, that Canco has made a valid Fresh Start Section 95 Election.

Application of paragraphs 95(2)(k.2) and (k.3)

Forco would be deemed to have, immediately before the end of its 1996 taxation year, disposed of all of its property for proceeds equal to fair market value of that property at that time.

In connection with the deemed disposition of the capital property, Forco would be deemed to have a capital gain of $4 million (i.e., $10 million minus $6 million). Therefore, the taxable capital gain would be $3 million (i.e., 3/4 times $4 million). The $3 million of taxable capital gains would be included in computing Forco's FAPI for its 1996 taxation year and would be included in Forco's taxable surplus. The non-taxable portion of the capital gain (i.e., $1 million) would be included in computing Forco's exempt surplus. Following the deemed reacquisition of the capital property at the end of its 1996 taxation year, Forco would have a cost in the amount of $10 million for the capital property.

In connection with the deemed disposition of the inventory, Forco would be deemed to have income of $2 million (i.e., $4 million minus $2 million) that would be included in computing FAPI for its 1996 taxation year and would be included in computing Forco's taxable surplus. Following the deemed reacquisition of the inventory at the end of its 1996 taxation year, Forco would have a cost in the amount of $4 million for the inventory.

ITA
95(2)(*k*.4)

The fresh start rules provided for in new paragraphs 95(2)(*k*) and (*k*.1) and in new paragraphs 95(2)(*k*.2) and (*k*.3), respectively, do not apply to a business the income from which is subject to tax under Part I of the Act. New paragraph 95(2)(*k*.4) provides for a rule to deal with the situation where income from part of the business is subject to tax under Part I of the Act.

New paragraph 95(2)(*k*.4) provides that, if at any time a foreign affiliate of a taxpayer resident in Canada, or a partnership at the end of the fiscal period of which includes that time a foreign affiliate of a taxpayer resident in Canada is a member, (which foreign affiliate or partnership is referred to as the "operator"), carries on a business both outside Canada and in Canada and income from that particular part of that business that is carried on in Canada is subject to tax under Part I of the Act, for the purposes of paragraphs 95(2)(*k*) to (*k*.3)

- the particular part of the business is deemed to be, at that time, a separate business,

- the assets used, or held, at that time primarily in the course of carrying on the particular part of the business are deemed to be, at that time, used or held in the course of carrying on the separate business,

- any liability incurred, and any reserve established, at that time in the course of carrying on the particular part of the business are deemed to be, at that time, incurred or established in the course of carrying on the separate business, and

- the transactions conducted at that time in the particular part of the business are deemed, at that time, to be transactions conducted in the separate business.

New paragraph 95(2)(*k*.4) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this paragraph is included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*k*.5) and (*k*.6)

New paragraph 95(2)(*k*.6), in combination with new paragraph 95(2)(*k*.5), provides application rules for the purpose of new paragraph 95(2)(*k*.1) or (*k*.3), as the case may be.

New paragraph 95(2)(*k*.5) provides that new paragraph 95(2)(*k*.6) applies for the purpose of paragraph 95(2)(*k*.1) or (*k*.3), as the case may be, in respect of a particular business of an operator if

- the particular business is the operator's foreign business for the specified taxation year described in paragraph 95(2)(*k*) or for the preceding taxation year or fiscal period described in subparagraph 95(2)(*k*.2)(iii), as the case may be,

- the activities of the particular business for that taxation year or fiscal period include activities (referred to as the "described activities")
  - that are described in clause 95(2)(*k*)(iii)(B) or (*k*.2)(iii)(B),
  - that are deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for that taxation year or fiscal period, and
  - that were not all the activities of the particular business in that taxation year or fiscal period.

New subparagraph 95(2)(*k*.6) provides that, in applying paragraph 95(2)(*k*.1) or (*k*.3), as the case may be,

- the part of the particular business that consists of the "described activities" that are deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period of the operator referred to in paragraph 95(2)(*k*.1) or (*k*.3), as the case may be, is deemed to be the operator's foreign business carried on in that taxation year or fiscal period (subparagraph 95(2)(*k*.6)(i)),

- the assets used or held by the operator primarily in the course of carrying on the "described activities" that are deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph 95(2)(*k*) or (*k*.2), as the case may be, are deemed to be assets used or held by the operator in the course of carrying on the foreign business in that taxation year or fiscal period (subparagraph 95(2)(*k*.6)(ii)),

- the portion of the liabilities incurred and the portion of the reserves established, in the course of carrying on the "described activities" that are deemed by any of paragraphs 95(2)(*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph 95(2)(*k*) or (*k*.2), as the case may be, are deemed to be liabilities incurred and reserves established in the course of carrying on the foreign business in that taxation year or fiscal period (subparagraph 95(2)(*k*.6)(iii)), and

- subject to subparagraphs 95(2)(*k*.6)(ii) and (iii), the transactions conducted in the course of carrying on the "described activities" that are deemed by any of paragraphs (*a*.1) to (*b*) to be a separate business, other than an active business, carried on by the operator for a taxation year or for a fiscal period referred to in paragraph 95(2)(*k*) or (*k*.2), as the case may be, are, to the extent that those transactions relate to those activities, deemed to be transactions conducted in the course of carrying on the foreign business in that taxation year or fiscal period (subparagraph 95(2)(*k*.6)(iv)).

New paragraphs 95(2)(*k*.5) and (*k*.6) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these paragraphs are included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*l*)

Paragraph 95(2)(*l*) includes in the income, of a foreign affiliate of a taxpayer, from property the affiliate's income derived from a business the principal purpose of which is to derive income from trading or dealing in certain indebtedness (including the earning of interest on such indebtedness). Where the business of the affiliate is described in subparagraph 95(2)(*l*)(iii) and the taxpayer is described in subparagraph 95(2)(*l*)(iv), paragraph 95(2)(*l*) does not apply to the affiliate.

Subparagraph 95(2)(*l*)(iii) refers to a business that is carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated in the country under whose laws the affiliate was formed or continued and exists and is governed and in which the business is principally carried on.

Subparagraph 95(2)(*l*)(iii) is amended to refer to a business that is carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of each country in which the business is carried on and of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued,

- of the country in which the business is principally carried on, or
- if the affiliate is related to a non-resident corporation, of the country under whose laws that non-resident corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union.

Amended subparagraph 95(2)(*l*)(iii) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after 2001.

ITA
95(2)(*n*)

Paragraph 95(2)(*a*) includes, in computing the income from an active business for a taxation year of a foreign affiliate of a taxpayer in respect of which the taxpayer has a "qualifying interest" throughout the year, certain amounts (as more particularly described in the various subparagraphs of paragraph 95(2)(*a*)) that would otherwise be the affiliate's income from property.

For example, subparagraph 95(2)(*a*)(ii) deals with the situation where the affiliate derives income from certain amounts paid or payable to it by another "foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest" throughout the year (or from a partnership of which that other affiliate is a member at the end of the year).

Paragraph 95(2)(*m*) determines whether a taxpayer has a "qualifying interest" in respect of a non-resident corporation that is a foreign affiliate of the taxpayer. This paragraph will not apply if the non-resident corporation is not a foreign affiliate of the taxpayer.

New paragraph 95(2)(*n*) accommodates a wider variety of corporate structures where the taxpayer has an indirect interest in a non-resident corporation.

Under new paragraph 95(2)(*n*), a non-resident corporation is deemed to be, at any time, a "foreign affiliate of a particular corporation resident in Canada in respect of which the particular corporation has a qualifying interest" if, at that time

- the non-resident corporation is a foreign affiliate of another corporation that is resident in Canada and that is related (otherwise than because of a right referred to in paragraph 251(5)(*b*) of the Act) to the particular corporation, and
- that other corporation has a qualifying interest in respect of the non-resident corporation.

New paragraph 95(2)(*n*) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that that paragraph is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Example

Facts:

1. *Canco1 is a corporation resident in Canada.*
2. *FA1 is a corporation not resident in Canada. Canco1 owns all of the issued and outstanding shares in FA1.*
3. *Canco2 is a corporation resident in Canada. Canco1 owns all of the issued and outstanding shares in Canco2.*
4. *FA2 is a corporation not resident in Canada. Canco2 owns all of the issued and outstanding shares of FA2.*

Application of paragraph 95(2)(n):

In the absence of paragraph 95(2)(n), FA1 would not be a "foreign affiliate of Canco2 in respect of which Canco2 has a qualifying interest" because FA1 is not a foreign affiliate of Canco2 within the meaning of the definition "foreign affiliate" in subsection 95(1). Paragraph 95(2)(m) is of no assistance in this regard. Thus, income derived by FA2 from amounts paid or *payable to it by FA1 could not satisfy paragraph 95(2)(a)(ii) in respect of Canco2.*

Under paragraph 95(2)(n), FA1 is deemed to be a "foreign affiliate of Canco2 in respect of which Canco2 has a qualifying interest" because

- *Canco1 and Canco2 are related,*
- *FA1 is a foreign affiliate of Canco1, and*
- *Canco1 has, because of paragraph 95(2)(m), a qualifying interest in respect of FA1.*

ITA
95(2)(*o*)

New paragraph 95(2)(*o*) defines the expression "qualifying member" of a partnership. This new definition is relevant for the amended definition "investment business" in subsection 95(1) and for amended subparagraph 95(2)(*a*)(ii). For more detail, see the commentaries to subsection 95(1) and paragraph 95(2)(*a*).

The definition "qualifying member" in paragraph 95(2)(*o*) is also the basis for the new definition "qualifying member" in subsection 248(1). The latter is relevant for the purpose of the new definition "exempt earnings" in new subsection 5907(1) of the Regulations. For more detail, see the commentary to subsection 248(1) of the Act and subsection 5907(1) of the Regulations.

New paragraph 95(2)(*o*) provides that a particular person is a "qualifying member" of a partnership at any particular time if, at that particular time, the particular person is a member of the partnership and

- throughout the period, in the fiscal period of the partnership that includes the particular time, during which the member is a member of the partnership, the particular person is, on a regular, continuous and substantial basis
  - actively engaged in those activities, of the principal business of the partnership carried on in that fiscal period by the

partnership, that are other than activities connected with the provision of or the acquisition of funds required for the operation of that principal business (clause 95(2)(*o*)(i)(A)), or

  - actively engaged in those activities, of a particular business carried on in that fiscal period by the particular person (otherwise than as a member of a partnership) that is similar to the principal business carried on in that fiscal period by the partnership, that are other than activities connected with the provision of or the acquisition of funds required for the operation of the particular business (clause 95(2)(*o*)(i)(B)), or

- throughout the period, in the fiscal period of the partnership that includes the particular time, during which the member was a member of the partnership

  - the total of the fair market value of all partnership interests in the partnership owned by the particular person was equal to or greater than 1% of the total of the fair market value of all partnership interests in the partnership owned by all members of the partnership (clause 95(2)(*o*)(ii)(A)), and

  - the total of the fair market value of all partnership interests in the partnership owned by the particular person or persons (other than trusts) related to the particular person was equal to or greater than 10% of the total of the fair market value of all partnership interests in the partnership owned by all members of the partnership (clause 95(2)(*o*)(ii)(B)).

New paragraph 95(2)(*q*) provides look-through rules that apply where partnership interests in a partnership are owned by another partnership or by a "non-discretionary trust" (within the meaning assigned by subsection 17(15) of the Act). See the commentary to paragraph 95(2)(*q*) for more detail.

New paragraph 95(2)(*o*) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that that paragraph is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*p*)

New paragraph 95(2)(*p*) provides a definition for the expression "qualifying shareholder" of a corporation. This new expression is relevant for the amended definition "investment business" in subsection 95(1) of the Act. For more detail, see the commentary to that.

New paragraph 95(2)(*p*) provides that a particular person is a "qualifying shareholder" of a corporation at any time if throughout the period, in the taxation year of the corporation that includes that time, during which the particular person is a shareholder of the corporation,

- the particular person owns not less than 1% of the issued and outstanding shares (having full voting rights under all circumstances) in the corporation,

- the particular person, or the particular person and persons (other than trusts) related to the particular person, own 10% or more of the issued and outstanding shares (having full voting rights under all circumstances) in the corporation,

- the total of the fair market value of all the issued and outstanding shares of the corporation owned by the particular person is 1% or more of the total fair market value of all the issued and outstanding shares in the corporation, and

- the total of the fair market value of all the issued and outstanding shares of the corporation owned by the particular person or by persons (other than trusts) related to the particular person is 10% or more of the total fair market value of all the issued and outstanding shares in the corporation.

New paragraph 95(2)(*q*) provides look-through rules that apply if shares in the corporation are owned by a partnership or by a "non-discretionary trust" (within the meaning assigned by subsection 17(15) of the Act). See the commentary to paragraph 95(2)(*q*) for more detail.

New paragraph 95(2)(*p*) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that that paragraph is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

ITA
95(2)(*q*)

New paragraph 95(2)(*q*) provides look-through rules for the purposes of

- applying new paragraph 95(2)(*o*) if partnership interests in the partnership referred to in paragraph 95(2)(*o*) are owned by another partnership or by a "non-discretionary trust" (within the meaning assigned by subsection 17(15) of the Act), and

- applying new paragraph 95(2)(*p*) if shares in the corporation referred to in paragraph 95(2)(*p*) are owned by a partnership or by such a "non-discretionary trust".

New paragraph 95(2)(*q*) provides that, in applying paragraphs 95(2)(*o*) and (*p*),

- if, at any time, interests in a partnership or shares of a corporation (such interests or shares referred to as "equity interests") are property of a partnership or are deemed by paragraph 95(2)(*q*) to be property of the partnership, the equity interests are deemed to be owned at that time by each member of the partnership in a proportion equal to the proportion of the equity interests that

  - the fair market value at that time of the member's partnership interest in the partnership

  is of

  - the fair market value at that time of all partnership interests in the partnership; and

- if, at any time, interests in a partnership or shares of a corporation (such interests or shares referred to as "equity interests") are property of a non-discretionary trust (within the meaning assigned by subsection 17(15)) or are deemed under paragraph 95(2)(*q*) to be property of a non-discretionary trust, the equity interests are deemed to be owned at that time by each beneficiary under that trust equal to that proportion of the equity interests that

- the fair market value at that time of the beneficiary's beneficial interest in the trust

is of

- the fair market value at that time of all beneficial interests in the trust.

New paragraph 95(2)(*q*) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that that paragraph is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Rule for Definition "investment business"

ITA
95(2.1)

Subsection 95(2.1) of the Act provides a rule for the purpose of the arm's length test in paragraph (*a*) of the definition "investment business" in subsection 95(1). Under this rule, a foreign affiliate of a taxpayer, the taxpayer and, in certain circumstances, a regulated financial institution in Canada of which the taxpayer is a subsidiary wholly-owned corporation, are considered to be dealing with each other at arm's length in respect of the entering into (and the execution of) agreements that provide for the purchase or sale, or exchange, of currency where all four of the conditions specified in paragraphs 95(2.1)(*a*) to (*d*) are satisfied.

The first condition, as specified in paragraph 95(2.1)(*a*), is that the taxpayer be (or be a corporation all of the issued shares of which are owned by a corporation that is) a bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities, the business activities of which are by law subject to the supervision of the Superintendent of Financial Institutions or a similar provincial authority.

The second condition, as specified in paragraph 95(2.1)(*b*), is that the agreements be swap agreements, forward purchase or sale agreements, forward rate agreements, futures agreements, options or rights agreements or similar agreements.

The third condition, as specified in paragraph 95(2.1)(*c*), is that the foreign affiliate entered into the agreements in the course of a business carried on principally with arm's length persons in the country in which the affiliate was formed (or continued) and exists and is governed, and in which the business is principally carried on by it.

The fourth condition, as specified in paragraph 95(2.1)(*d*), is that the terms and conditions of the sale or exchange be arm's length terms and conditions.

Subsection 95(2.1) permits a foreign affiliate of a taxpayer to deal with Canadian financial institutions in currency transactions entered into in the course of a business carried on by the affiliate principally with arm's length persons in the foreign country under whose laws the affiliate was incorporated, exists and is governed, and in which the business is principally carried on. Such currency transactions of the affiliate are afforded the same tax treatment as that given to similar transactions conducted with foreign financial institutions.

Paragraph 95(2.1)(*c*) is amended to require that the foreign affiliate entered into the agreements

- in the course of carrying on, principally with persons with whom the affiliate deals at arm's length, a business (other than a life insurance business) principally carried on in the country (other than Canada) under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, or

- in the course of a life insurance business carried on by the affiliate principally in a country other than Canada and principally with persons with whom the affiliate deals at arm's length if
  - that country is the country in which the business is principally carried on or is the country under whose laws the affiliate is

governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued (new clause 95(2.1)(*c*)(ii)(A)), and

- the business activities of the affiliate are regulated in each of the countries described in new clause 95(2.1)(*c*)(ii)(A).

Amended subsection 95(2.1) will, for example, accommodate currency transactions of certain regulated foreign affiliates, of regulated life insurance corporations resident in Canada, that carry on an arm's length foreign life insurance business principally in a country different from their country of incorporation or continuation if the business activities are regulated in the country in which the business is principally carried on and in the country under whose laws the affiliate was incorporated or last continued.

The amendment to paragraph 95(2.1)(*c*) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after 1999. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Rule for Subsection (2)

ITA
95(2.2)

Subsection 95(2.2) of the Act provides rules, in paragraphs 95(2.2)(*a*) and (*b*), for the purpose of subsection 95(2).

Paragraph 95(2.2)(*a*) provides that, in certain circumstances, a non-resident corporation that was not a "foreign affiliate of a taxpayer in respect of which the taxpayer had a qualifying interest throughout a taxation year" but was such a foreign affiliate at the beginning or end of that year is deemed to be such a foreign affiliate of the taxpayer throughout that year. Those circumstances are that a person has, in that year, acquired or disposed of shares of that non-resident corporation or any other corporation and, because of that disposition or acquisition, that non-resident corporation became or ceased to be a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest.

Paragraph 95(2.2)(*b*) provides that, in certain circumstances, a non-resident corporation that was not related to a taxpayer and to a foreign affiliate of the taxpayer throughout a taxation year but was so related at the beginning or end of that year is deemed to be related throughout that year to the taxpayer and to the foreign affiliate. Those circumstances are that a person has, in that year, acquired or disposed of shares of that non-resident corporation or any other corporation and, because of that disposition or acquisition, that non-resident corporation became or ceased to be a non-resident corporation that was related to the foreign affiliate and the taxpayer.

Subsection 95(2.2) is amended in the following ways.

First, paragraph 95(2.2)(*b*) is amended so that the rule in that paragraph also applies if, because of the acquisition, that non-resident corporation would have become (if paragraph 251(5)(*b*) of the Act did not apply to rights contained in the agreement under which the person acquired the shares) a non-resident corporation that was related to the taxpayer and the foreign affiliate. The addition of the reference to paragraph 251(5)(*b*) permits paragraph 95(2.2)(*b*) to apply where the relevant commercial arrangements involve a right to acquire shares which is then exercised.

Second, the "preamble" of subsection 95(2.2) is amended to ensure that that subsection does not apply for the purpose of paragraph 95(2)(*f*). This amendment is consequential to the introduction of new subsection 95(2.22). For additional detail, see the commentary to subsection 95(2.22).

The amendments to paragraph 95(2.2)(*b*) and to the "preamble" of subsection 95(2.2) apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Exception re Subsection (2.2)

ITA
95(2.21)

New subsection 95(2.21) of the Act ensures that the application of the rules in subsection 95(2.2) will not result in the provisions of paragraph 95(2)(*a*) recharacterizing, as an income or a loss from an active business, any income or loss from property of a particular foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest throughout the taxation year of that particular affiliate, that relates to a transaction or event

- that occurred before that particular affiliate became, as determined without reference to subsection 95(2.2), a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest; or

- that occurred before a non-resident corporation (other than that particular affiliate), or a foreign affiliate of the taxpayer (other than that particular affiliate), referred to in paragraph 95(2)(*a*) became, as determined without reference to subsection 95(2.2),

    - a foreign affiliate of a taxpayer in respect of which the taxpayer had a qualifying interest, or

    - related to the taxpayer and that particular affiliate.

New subsection 95(2.21) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that this subsection is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Rule for Paragraph (2)(*f*)

ITA
95(2.22)

Paragraph 95(2)(*f*) of the Act sets out rules for determining the taxable capital gain or allowable capital loss of a foreign affiliate of a taxpayer from the disposition of property. One of those rules is that, in computing any such gain or loss from the disposition of property owned by the affiliate at the time it last became a foreign affiliate of a taxpayer, there shall not be included the portion of the gain or loss that can reasonably be considered to have accrued during the period that the affiliate was not a foreign affiliate of the taxpayer or of any other person specified in subparagraphs 95(2)(*f*)(iii) to (vii).

Existing subsection 95(2.2) provides rules for the purpose of subsection 95(2). However, consequential to the introduction of new subsection 95(2.22), subsection 95(2.2) will no longer provide rules for the purpose of paragraph 95(2)(*f*). For additional details about existing subsection 95(2.2) and the amendments being made to it, refer to the commentary to subsection 95(2.2).

New subsection 95(2.22) provides rules for the purpose of paragraph 95(2)(*f*). That subsection provides that a non-resident corporation is deemed to be a foreign affiliate of the taxpayer at the beginning of a taxation year of the corporation if

- the corporation was not a foreign affiliate of the taxpayer at the beginning of the year,
- at the end of the year, the corporation was a foreign affiliate of the taxpayer, and
- a person has, in the year, acquired or disposed of shares of the corporation or of any other corporation and, because of that acquisition or disposition, the non-resident corporation became a foreign affiliate of the taxpayer.

New subsection 95(2.22) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that this subsection is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Exception re Subsection (2.22)

ITA
95(2.23)

New subsection 95(2.23) of the Act provides an exception to the rules in subsection 95(2.22). Subsection 95(2.23) of the Act provides that subsection 95(2.22) does not apply for the purpose of determining whether or not any taxable capital gain or allowable capital loss realized by a non-resident corporation can reasonably be considered to have accrued while the affiliate was not a foreign affiliate of the taxpayer or of any other person specified in subparagraphs 95(2)(*f*)(iii) to (vii). Subsection 95(2.23) ensures that capital gains and losses of a foreign affiliate, for the taxation year in which the affiliate becomes a foreign affiliate of the taxpayer and for subsequent taxation years, will not include taxable capital gains and allowable capital losses of the affiliate that accrued before the affiliate would have become a foreign affiliate of the taxpayer if the Act were read without reference to subsection 95(2.22).

New subsection 95(2.23) applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999. Note that this subsection is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Exception re Paragraph (2)(*a*.3)

ITA
95(2.4)

In general terms, paragraph 95(2)(*a*.3) of the Act deems income of a foreign affiliate of a taxpayer from Canadian source indebtedness, or from Canadian source lease obligations, to be income from a business other than an active business. Therefore, this income will be included in computing the affiliate's foreign accrual property income (FAPI).

Subsection 95(2.4) provides that paragraph 95(2)(*a*.3) will not apply in respect of income derived by a foreign affiliate of a taxpayer directly or indirectly from indebtedness to the extent that

- the income was derived by the affiliate in the course of a business that was conducted principally with persons with whom the affiliate deals at arm's length, and that was carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities, the activities of which are regulated in the jurisdiction in which it was formed or continued and exists and is governed, and in which the business was principally carried on (paragraph 95(2.4)(*a*)), and

- the income was derived from the trading or dealing in such indebtedness with arm's length persons resident in a country other than Canada in which the affiliate and its similarly regulated competitors compete and have a substantial market presence (paragraph 95(2.4)(*b*)).

Paragraph 95(2.4)(*a*) is amended to refer to income derived by the affiliate in the course of a business that was conducted principally with persons with whom the affiliate deals at arm's length, and that was carried on by the affiliate as a foreign bank, a trust company, a credit union, an insurance corporation, or a trader or dealer in securities or commodities, the activities of which are regulated under the laws

- of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued and of each country in which the business is carried on,

- of the country in which the business is principally carried on, or

- if the affiliate is related to a corporation, of the country under the laws of which the related corporation is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all of those countries are members of the European Union.

Amended paragraph 95(2.4)(*a*) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after 2001.

Exception re Paragraph (2)(*a*.3)

ITA
95(2.41)

In general terms, paragraph 95(2)(*a*.3) of the Act deems income of a foreign affiliate of a taxpayer from Canadian source indebtedness, or from Canadian source lease obligations, to be income from a business other than an active business. This income will therefore be included in computing the affiliate's FAPI.In general terms, new subsection 95(2.41) of the Act provides that paragraph 95(2)(*a*.3) will not apply to income of a foreign affiliate of a taxpayer from Canadian source indebtedness held by that affiliate where that indebtedness is used or held

- to fund a liability or reserve of the foreign life insurance business of the affiliate, or

- as capital that can reasonably be considered to have been required for that life insurance business.

More specifically, new subsection 95(2.41) provides that, where four conditions are met, paragraph 95(2)(*a*.3) does not apply to a foreign affiliate of a taxpayer resident in Canada in respect of the affiliate's income for a taxation year derived, directly or indirectly, from indebtedness of persons resident in Canada or from indebtedness in respect of businesses carried on in Canada (referred to as the "Canadian indebtedness").

The first condition, set out in paragraph 95(2.41)(*a*), is that the taxpayer be at the end of the affiliate's taxation year

- a life insurance corporation resident in Canada, the business activities of which are subject by law to the supervision of the Superintendent of Financial Institutions or a similar authority of a province, or

- a corporation resident in Canada that is a subsidiary controlled corporation of such a life insurance corporation.

The second condition, set out in paragraph 95(2.41)(*b*), is that the Canadian indebtedness be used or held by the affiliate, throughout the period (in the taxation year) that it was used or held by the affiliate, in the course of carrying on a business (referred to as the "foreign life insurance business") that is a life insurance business carried on outside Canada (other than a business deemed by paragraph 95(2)(*a*.2) to be a "separate business other than an active business"), the activities of which are regulated

- in the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, and

- in the country, if any, in which the business is principally carried on.

The third condition, set out in paragraph 95(2.41)(*c*), is that more than 90% of the gross premium revenue of the affiliate for the taxation year in respect of the foreign life insurance business be derived from the insurance or reinsurance of risks (net of reinsurance ceded) in respect of persons

- that were non-resident at the time that the policies in respect of those risks were issued or effected, and

- that were at that time dealing at arm's length with the affiliate, the taxpayer and all persons that were related at that time to the affiliate or the taxpayer.

The fourth condition, set out in paragraph 95(2.41)(*d*), is that it be reasonable to conclude that the affiliate used or held the Canadian indebtedness

- to fund a liability or reserve of the foreign life insurance business, or

- as capital that can reasonably be considered to have been required for the foreign life insurance business.

In general terms, new subsection 95(2.41) ensures that a life insurer can hold Canadian source indebtedness in its foreign life insurance business without causing the income from that indebtedness to be treated as FAPI of the foreign affiliate.

New subsection 95(2.41) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after 1999. Note that this subsection is included in the Global Section 95 Election package described at the beginning of the commentary to section 95.

Definition of "services"

ITA
95(3)(*c*) and (*d*)

Paragraph 95(2)(*b*) of the Act provides that service income of a controlled foreign affiliate of a taxpayer will, under certain circumstances, be treated as income from a business other than an active business.

Subsection 95(3) provides that, for the purpose of paragraph 95(2)(*b*), "services" includes the insurance of Canadian risks but does not include

- the transportation of persons or goods (paragraph 95(3)(*a*)), or
- services performed in connection with the purchase or sale of goods (paragraph 95(3)(*b*)).

New paragraph 95(3)(*c*) ensures that, for the purpose of paragraph 95(2)(*b*), the transmission of electronic signals or electricity along a transmission system located outside Canada does not constitute "services".

New paragraph 95(3)(*d*) accommodates certain types of contract manufacturing services provided by a foreign affiliate of a taxpayer. That paragraph ensures that, for the purpose of paragraph 95(2)(*b*), manufacturing or processing does not constitute "services" where it consists of manufacturing or processing outside Canada, in accordance with the taxpayer's specifications and under a contract between the taxpayer and the affiliate, of tangible property that is owned by the taxpayer if the property resulting from the manufacturing or processing is used or held by the taxpayer in the ordinary course of the taxpayer's business carried on in Canada.

New paragraphs 95(3)(*c*) and (*d*) apply to the 2001 and subsequent taxation years of a foreign affiliate of a taxpayer.

Definition of "designated property"

ITA
95(3.1)

New subsection 95(3.1) of the Act provides, for the purpose of amended subparagraph 95(2)(*a*.1)(i) of the Act, a definition of the expression "designated property". For more detail about that definition, see the commentary to subparagraph 95(2)(*a*.1)(i).

New subsection 95(3.1) applies after to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date; however, this amendment is included in the Global Section 95 Election package described in the beginning of the commentary on section 95.

Clause 40

Partnerships and Their Members

ITA
96

Section 96 of the Act provides general rules for determining the income or loss of a partnership and its members.

Income Allocation to Former Member

ITA
96(1.01)

New subsection 96(1.01) of the Act generally applies to the 1995 and subsequent taxation years. Paragraph 96(1.01)(*a*) deems a taxpayer who is a former member of a partnership to be a member at the end of the fiscal period in which the taxpayer ceased to be a member, for the purpose of allocating partnership income or loss for that period. This new provision clarifies that, although a taxpayer may have ceased to be a member of a partnership before the end of the partnership's fiscal period, an amount of the income or loss of the partnership is allocable to the taxpayer under subsection 96(1) of the Act. The amount so allocated is relevant to certain calculations relating to partnership income or loss, including the calculation of the adjusted cost base of the former member of the partnership immediately before the taxpayer ceased to be member.

New subsection 96(1.01) applies notwithstanding the rule in paragraph 98.1(1)(*d*) of the Act that would otherwise deem a former partnership member with a residual interest not to be a member of the partnership for the purposes of certain provisions of the Act.

New paragraph 96(1.01)(*a*) does not require that partnership income or loss be calculated immediately after a member leaves the partnership. The income or loss allocation, including that of the former member, continues to be calculated after the end of the partnership's fiscal period. In some circumstances the fiscal period of a partnership may end in a taxation year of the former member that is after the taxation year in which the partnership interest was disposed of. It is, therefore, possible that a member will not be required to report a partnership income allocation until the taxation year following that in which a capital gain or loss on the disposition of the partnership interest is required to be reported.

New paragraph 96(1.01)(*b*) clarifies that an income or loss allocation for the "stub period" during which a taxpayer was a member is included in the calculation of the adjusted cost base of the partnership interest at the time the former member disposes of the interest or a residual interest. The income or loss allocation will affect the calculation of a capital loss under paragraph 98.1(1)(*c*) or subsection 100(2) of the Act. Subsection 96(1.01) may ameliorate certain situations where, under the existing provisions of the Act, a former member may have been required to report a capital gain in the year that the person left the partnership, only to be offset by a capital loss in a subsequent year.

Example

Ms. Brown was a partner in XYZ Partnership until June 30. The fiscal period end of the partnership ends December 31. The adjusted cost base of her partnership interest on January 1 was Nil. From January to June 30 she withdrew $16,000 in capital.

Just before the end of the partnership's fiscal period, all the partners agree that Ms. Brown's share of income for the period was $20,000. On December 30 she was paid $4,000 in satisfaction of her residual interest.

A summary of Ms. Brown's adjusted cost base is as follows:

		Adjusted Cost Base
January 1, Year 1:		*Nil*
January 31, Drawings	*$ <16,000>*	*<16,000>*
Retirement of Ms. Brown, June 30		
December 30		
- Share of income for 6 months	*20,000*	*4,000*
- Payout of rights to equity	*4,000*	*Nil*

December 31 - Fiscal period ends

In the result, Ms. Brown is allocated $20,000 income under subsection 96(1.01). The adjusted cost base of her interest immediately before she retired on June 30 was $4,000 (i.e., $20,000 less $16,000). She is deemed by paragraph 98.1(1)(b) to have disposed of her residual interest on December 31 for proceeds of disposition of $4,000, such that she has no capital gain or loss on the disposition.

Subparagraph 53(1)(*e*)(v) of the Act requires that "rights or things" (referred to in subsection 70(2) of the Act) in respect of the partnership interest of a deceased partner be included in the adjusted cost base of the partnership interest of the deceased. This provision is no longer relevant to income of the partnership to which a partner is entitled at the time of death, since new subsection 96(1.01) applies to the allocation of partnership income for the fiscal period in which the taxpayer dies. However, subparagraph 53(1)(*e*)(v) continues to apply in respect of other rights or things, if any, to which the deceased taxpayer is entitled through the partnership that are required to be included in the income of the deceased taxpayer under subsection 70(2).

Limited Partner

ITA
96(2.4)(*a*)

Subsection 96(2.4) of the Act provides an extended definition of "limited partner" for the purpose of applying the limited partnership at-risk rules in subsection 96(2.2).

Paragraph 96(2.4)(*a*) provides that a member of a partnership is a "limited partner" if, by operation of law governing the partnership agreement, the liability of the member as a member is limited. However, paragraph 96(2.4)(*a*) does not apply in cases where a member's liability is limited by operation of a statutory provision of Canada or of a province that limits the member's liability only for the debts, obligations and liabilities of a limited liability partnership (or of any member of the partnership) arising from negligent acts or omissions of another member of the partnership (or of an employee, agent or representative of the partnership) in the course of the partnership business and while the partnership is a limited liability partnership.

The Province of Quebec has amended its legislation concerning partnerships to allow partners to carry on their activities within a limited liability partnership. That legislation refers to the civil law concept of "fault/fautes". The English version of paragraph 96(2.4)(*a*) does not refer to the civil law concept of "fault" and is amended to do so, effective after June 20, 2001.

Agreement or Election of Partnership Members

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended, for taxation years that end after February 27, 2000, to apply for the purposes of an election under subsection 14(1.01) of the Act in respect of the disposition of an eligible capital property.

Election by Partnership Member for 2000 Taxation Year

ITA
96

The calculation of the capital gains inclusion rate of a taxpayer for the 2000 taxation year takes into account the net capital gains or losses of the taxpayer for the year 2000 other than those allocated by a partnership. It is the inclusion rate of the taxpayer, determined without reference to the allocated partnership gains, that is applied to the taxpayer's share of the partnership gains in determining the taxable capital gains of the taxpayer derived from the partnership capital gains. As a result, taxpayers with different inclusion rates report different amounts of taxable capital gains in respect of capital gains allocated to the taxpayer by a partnership.

Subclause 40(7) of the legislation introduces a special transitional rule under which members of a partnership may elect to treat capital gains and losses allocated to them by a partnership as their own capital gains and losses for the purpose of calculating the taxpayer's capital gains inclusion rate for the year 2000. The gains and losses will be considered to have been realized by the taxpayer on the day on which the fiscal period of the partnership ends.

If a taxpayer so elects, subsection 96(1.7) of the Act will not apply. The taxpayer will be deemed to have realized (on the day on which the fiscal period of the partnership ends in the taxpayer's 2000 taxation year) a capital gain, a capital loss or a business investment loss in respect of the partnership equal to the amount of the taxable capital gain, the allowable capital loss or the allowable business investment loss, as the case may be, of the partnership allocated to the taxpayer, multiplied by the reciprocal of the fraction in paragraph 38(*a*) of the Act that applied to the partnership for the particular fiscal period. Where the inclusion rate for the partnership cannot be determined, the rules in subsection 96(1.7) apply to determine the inclusion rate of the partnership. This capital gain, capital loss or business investment loss is deemed to be a capital gain, capital loss or business investment loss, as the case may be, of the taxpayer from a disposition of a capital property on the day that the particular fiscal period ends.

Clause 41

Replacement of Partnership Capital

ITA
100(5)

Section 100 of the Act contains rules relevant to the calculation of capital gains and losses in respect of an interest in a partnership. There may be circumstances under which a former member of a partnership or an heir of a deceased member is required to pay an amount to the partnership to cover a deficit in the former member's equity account. Such a situation could arise, for instance, where the partnership has a net loss for the partnership's fiscal period in which the taxpayer ceased to be a member. The former member may have been deemed to have realized a capital gain under subsection 100(2) of the Act upon disposition of the partnership interest, if the former member had at that time a "negative" adjusted cost base under section 54 of the Act (if such a negative balance were allowed under that section).

New subsection 100(5) of the Act, which generally applies to the 1995 and subsequent taxation years, deems a taxpayer to have a capital loss from the payment by the taxpayer of an amount after the time of disposition of the partnership interest, if that amount would have been a capital contribution to the partnership if the taxpayer had still been a member at the time of the payment. The loss is available to the former member or to an heir who has been deemed by subsection 100(3) of the Act to have acquired a right to acquire partnership property.

Example

Mr. Green was a partner in XYZ Partnership until June 30. The fiscal period end of the partnership was December 31. The adjusted cost base of his partnership interest on January 1 was Nil. From January to June 30 he withdrew $16,000 in capital.

Shortly after the fiscal period end, all the partners agree that Mr. Green's share of the partnership loss for the period was $20,000. During the following year he paid $36,000 owing by him to the partnership in satisfaction of his obligation.

A summary of Mr. Green's adjusted cost base is as follows:

		Adjusted Cost Base
January 1, Year 1:		Nil
January 31, Drawings	$ <16,000>	<16,000>
Retirement of Mr. Green, June 30		
December 31, Year 1, Share of loss for 6 months	<20,000>	<36,000>
March 31 - Repayment of partnership capital	36,000	Nil

Mr. Green is entitled to claim a partnership loss of $20,000 for the taxation year in which he retired ("Year 1"). He had a $36,000 "negative" adjusted cost base for his partnership interest as at the time that he left the partnership, giving rise to a deemed capital gain under subsection 100(2) of the Act for Year 1. However, he will be allowed a $36,000 capital loss under subsection 100(5) for the taxation year in which he repaid the deficit.

Clause 42

Trusts and Their Beneficiaries

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

Restricted Meaning of "beneficiary"

ITA
104(1.1)

Subsection 104(1.1) of the Act applies for the purpose of identifying beneficiaries under a trust for the purposes of subsection 104(1), subparagraph 73(1.02)(*b*)(ii) and paragraphs 104(4)(*a*.4) and 107.4(1)(*e*) of the Act.

Subsection 104(1.1) is amended to clarify that it applies notwithstanding subsection 248(25) of the Act. Subsection 248(25) of the Act describes, for other purposes of the Act, the circumstances in which a person or partnership is considered to be "beneficially interested" in a trust.

This amendment applies to the 1998 and subsequent taxation years.

Deemed Gains – Subsection (21.4) Applies

ITA
104(21.6)

Subsection 104(21.6) of the Act provides rules for the determination of the inclusion rate to be used by a taxpayer for capital gains realized by a trust in 2000. This subsection applies to a taxpayer who has a taxation year that begins after October 17, 2000 and who is deemed by subsection 104(21.4) to have capital gains from the disposition of capital property in the year in respect of dispositions of property by a trust of which the taxpayer is a beneficiary.

This subsection ensures that the inclusion rate for capital gains realized on property disposed of by a trust prior to February 27, 2000 is 3/4, and is 2/3 in respect of property disposed of by a trust after February 27, 2000 and before October 18, 2000.

Subsection 104(21.6) is amended to ensure that where the deemed gains are in respect of capital gains from dispositions of property by the trust that occurred after February 27, 2000 and before October 17, 2000 in circumstances where the taxation year of the taxpayer began after February 27, 2000 and ended after October 17, 2000, the gains are deemed to be a capital gain of the taxpayer from the disposition by the taxpayer of capital property in the taxpayer's taxation year and in the period that began after February 27, 2000 and ended before October 18, 2000.

This amendment applies to taxation years that end after February 27, 2000.

Amounts Deemed Payable to Beneficiaries

ITA
104(29)

Subsection 104(29) of the Act allows a trust to flow through to a beneficiary a reasonable share of "phantom income" realized at the trust level because of an inclusion of provincial Crown royalties in the trust's income. The phantom income is calculated generally net of the trust's resource allowance deduction claimed under paragraph 20(l)(*v*.1) of the Act. In order to benefit from the application of subsection 104(29) in a taxation year, the trust must designate an amount, not exceeding the amount determined under subsection 104(29), in its return of income for that year.

Subsection 104(29) is amended so that an amount designated by a trust in its return of income for a taxation year throughout which it was resident in Canada is deemed to have become payable, in the proportions that are designated by the trust in that return of income, by the trust to particular beneficiaries of the trust in the year if

- as required by paragraph 104(29)(*b*), the designated proportions are reasonable having regard to the shares of the trust-purpose income of the trust for the year included in computing the beneficiaries' incomes for the year, and
- the designated amount does not exceed the amount determined by the formula

$$(A - B) \times C/D.$$

The amounts described in the variables of this formula generally correspond with the amounts described in current paragraphs 104(29)(*a*) to (*d*). In some cases, the descriptions are modified to clarify their intended application. More particularly, variable A is the total of all amounts each of which is

- an amount that is not deductible in computing the trust's income for the year, but that would be deductible in computing that income if the Act were read without reference to paragraphs 18(1)(*l*.1) and (*m*),
- an amount that is required by paragraph 12(1)(*o*) or by subsection 69(6) or (7) to be included in computing that income, or
- an amount that is required to be included in computing that income because of an amount designated under this subsection by another trust.

New subparagraph (iii) of the description of A ensures that, in circumstances involving two or more tiers of trusts, the phantom income deemed payable under subsection 104(29) by a particular trust to a beneficiary of the particular trust that is another trust can be further flowed through, where subsection 104(29) applies to the other trust, by the other trust to the other trust's beneficiaries.

Variable B of the formula is the total of all amounts each of which is:

- an amount that is deductible (otherwise than because of the membership of the trust in a partnership) under paragraph 20(1)(*v*.1) in computing the trust's income for the year, or

- an amount that is not included in computing that income, but that would be included in computing that income if the Act were read without reference to section 80.2.

Variable C of the formula is the total of all amounts each of which is a part of the trust's income for the year, computed without reference to the provisions of the Act (in subsection 104(29) referred to as the "trust-purpose income of the trust for the year"), that was payable in the year to a beneficiary of the trust, or that was required by subsection 105(2) of the Act to be included in computing the income of a beneficiary of the trust.

Variable D is the trust-purpose income of the trust for the year.

These amendments apply to trust taxation years that end after Announcement Date.

Clause 43

Interests in Trusts

ITA
107

Section 107 of the Act provides certain rules relating to the acquisition and disposition of a capital interest in a trust.

Distribution by Personal Trust

ITA
107(2)

Subsection 107(2) of the Act applies where a personal trust or a prescribed trust described in section 4800.1 of the Regulations distributes property to a beneficiary and there is a resulting disposition of part or all of the beneficiary's capital interest in the trust. Under paragraph 107(2)(*a*), the trust is deemed to have disposed of the property for proceeds of disposition equal to the property's cost amount. Under paragraph 107(2)(*b*), the property is deemed to have been acquired by the beneficiary for an amount equal to the total of the amount described in paragraph 107(2)(*a*) and a "bump" equal to the specified percentage of any excess of the adjusted cost base to the beneficiary of the capital interest over its cost amount (as defined by subsection 108(1) of the Act) to the beneficiary of the interest. Under subparagraph 107(2)(*b*.1)(iii), the specified percentage for property (other than non-depreciable capital property and eligible capital property) is 75%. Where subsection 107(2) applies, paragraph 107(2)(*c*) provides that the beneficiary is deemed to have disposed of all or part, as the case may be, of the capital interest for proceeds equal to the amount determined under that paragraph.

Subparagraph 107(2)(*b*.1)(iii) is amended to replace the reference to 75% with a reference to 50%, consistent with the current capital gains inclusion rate.

Paragraph 107(2)(*c*) is amended to clarify that it applies to determine a taxpayer's proceeds of disposition of the capital interest in a trust (or of the part of it) disposed of by the taxpayer on a distribution, to which subsection 107(2) applies, of property by the trust.

These amendments apply to distributions, from a trust, that are made after Announcement Date.

Distribution of Property Received on Qualifying Disposition

ITA
107(4.2)

New subsection 107(4.2) of the Act prevents a tax-deferred distribution of property after Announcement Date from a personal trust or a trust prescribed for the purpose of subsection 107(2) of the Act to a beneficiary of the trust if specified conditions are met. The specified conditions are that:

- at a particular time before Announcement Date + 1 there was a qualifying disposition (within the meaning assigned by subsection 107.4(1) of the Act) of the property, or of other property for which the property is substituted, by a particular partnership or a particular corporation, as the case may be, to any trust; and

- the beneficiary is neither the particular partnership nor the particular corporation.

Where the specified conditions are met, subsection 107(2.1) will apply so that the trust is deemed to have disposed of the property for proceeds equal to the property's fair market value at the time of distribution.

This amendment applies to distributions, from a trust, that are made after Announcement Date.

Clause 44

Qualifying Disposition

ITA
107.4(1)

Subsection 107.4(3) of the Act generally provides for a rollover of property to a trust where the property is transferred to the trust by way of a qualifying disposition. For this purpose, subsection 107.4(1) defines "qualifying disposition" to be a disposition of property to a trust that does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions set out in that subsection. A partnership, corporation or individual (including a trust) are all qualified transferors for the purpose of applying the definition "qualifying disposition" in subsection 107.4(1). However, one of the conditions, found in paragraph 107.4(1)(*d*), is that the disposition not be by a partnership, if the disposition is part of a series of transactions or events that begins after December 17, 1999 and includes the cessation of the partnership's existence and a subsequent distribution from a personal trust to a former member of the partnership in circumstances to which subsection 107(2) of the Act applies.

Subsection 107.4(1) is amended so that after Announcement Date only an individual (including a trust) may make a qualifying disposition to a trust. As a result, paragraph 107.4(1)(*d*) is repealed.

These amendments are deemed to come into force on Announcement Date. For a related amendment, see the commentary to new subsection 107(4.2) of the Act.

Clause 45

Taxation of Trusts and Their Beneficiaries

ITA
108

Section 108 of the Act sets out certain definitions and rules that apply for the purposes of subdivision k, which deals with the taxation of trusts and their beneficiaries.

Definitions

ITA
108(1)

"testamentary trust"

Subsection 108(1) of the Act defines "testamentary trust" generally as a trust or estate that arose on and in consequence of the death of an individual, and provides some exceptions to that definition.

Subsection 104(1) of the Act provides that references to a "trust" in subdivision k (i.e., sections 104 to 108) of Division B of Part I of the Act include a trust or estate. The definition "testamentary trust" in subsection 108(1) is therefore amended to remove the reference to "estate" because the references in that definition to a "trust" include an estate. For more detail, see the commentary to subsection 104(1).

New paragraph (*d*) of the definition "testamentary trust" is an anti-avoidance rule. That new paragraph provides that a testamentary trust in a taxation year does not include a trust (in the commentary on this amendment, references to "trust" include an estate) that incurs, after Announcement Date and before the end of the taxation year, a debt or any other obligation to pay an amount to, or guaranteed by, a beneficiary or any person or partnership with whom any beneficiary of the trust does not deal at arm's length. However, such a debt will not affect the status of the trust as a testamentary trust if it is a debt or other obligation owed to a particular beneficiary of the trust and incurred by the trust in satisfaction of the particular beneficiary's right to enforce payment of an amount of income or capital gains payable by the trust to that beneficiary or to otherwise receive any part of the capital of the trust.

These amendments apply to trust taxation years that end after Announcement Date.

"trust"

For the purposes of the 21-year deemed disposition rule and other specified measures, subsection 108(1) of the Act defines "trust" to exclude certain listed trusts.

For these purposes, paragraph (*f*) of the definition excludes unit trusts (as defined in subsection 108(2) of the Act) and paragraph (*g*) excludes, except as specified, trusts all interests in which have vested indefeasibly.

This definition is amended so that section 106 of the Act is not a provision for the purposes of which paragraphs (*f*) and (*g*) of the definition apply. Section 106 provides rules in respect of an "income interest" (as defined in subsection 108(1) of the Act) in a "personal trust" (as defined in subsection 248(1) of the Act). As a result of this amendment, for the purpose of section 106, references to a trust will include a trust described in paragraph (*g*) of the definition "trust" in subsection 108(1). (As the definition "personal trust" expressly excludes a unit trust, paragraph (*f*) of the definition "trust" in subsection 108(1) is not relevant for this purpose.)

This amendment applies to the 1998 and subsequent taxation years.

Clause 46

Taxable Income – Deductions

ITA
110

Section 110 of the Act provides various deductions that may be claimed in computing a taxpayer's taxable income.

Part VI.1 Tax

ITA
110(1)(*k*)

Paragraph 110(1)(*k*) of the Act provides a deduction in computing a corporation's taxable income equal to a multiple of the amount of any tax payable by it for the year under Part VI.1 of the Act on dividends it paid on taxable preferred shares. The deduction approximates the income that would have generated an amount of income tax equal to the Part VI.1 tax. The multiple used to produce this result is currently 9/4, which implies a total federal and provincial income tax rate of 44.44%.

As part of a series of amendments reflecting recent and planned reductions in income tax rates, the multiple in paragraph 110(1)(*k*) is increased to 3. This amendment, which applies for the 2003 and subsequent taxation years, implies a total tax rate of 33.3%.

Taxable Income – Employee Security Options Deduction

ITA
110(1.7) and (1.8)

Subsection 110(1.7) of the Act provides that the definitions in subsection 7(7) of the Act relating to employee security options also apply for the purposes of subsections 110(1.5) and 110(1.6) of the Act. Since subsection 7(7) also provides for the definitions to so apply, existing subsection 110(1.7) is unnecessary and is repealed.

A new subsection 110(1.7) is added that applies in circumstances where there is a reduction in the amount (referred to in these notes as the "exercise price") payable by an employee to acquire securities under an employee security option and the conditions in new subsection 110(1.8) of the Act are satisfied.

This new subsection ensures that a reduction in the exercise price under an employee security option does not disqualify the employee from claiming the security option deduction under paragraph 110(1)(*d*) of the Act, if the reduction could have been effected by way of an exchange of options without jeopardizing the employee's eligibility for the deduction.

Paragraph 110(1)(*d*) of the Act provides a deduction in computing taxable income in circumstances where subsection 7(1) of the Act deems an employee to have received a benefit from employment in connection with the exercise or disposition of rights under an employee option agreement. The deduction is currently equal to one-half of the amount of the employment benefit, and the effect of the deduction is to tax the benefit at a rate equivalent to the capital gains inclusion rate.

Paragraph 110(1)(*d*) sets out certain conditions that must be satisfied in order to qualify for the security option deduction. These conditions include a minimum exercise price requirement under the option giving rise to the benefit under subsection 7(1) and, if that option was acquired as a consequence of one or more qualifying exchanges of options, under each of the previous options. Thus, if a reduction in the exercise price under an employee security option causes the exercise price to fall below the minimum threshold established under paragraph 110(1)(*d*) for that option, the employee will not be entitled to claim the security option deduction.

However, there are situations in which an otherwise disqualifying reduction in an option exercise price could be effected by way of an exchange of options without jeopardizing the employee's eligibility for the deduction. This would be the case, for example, if the exercise price had originally been set at the fair market value (FMV) of the underlying securities at the time of grant, there is a subsequent decline in the FMV of the securities and the exercise price is adjusted to that lower FMV. The combined effect of subsections 110(1.7) and (1.8) is to deem such a reduction to have been effected by way of an exchange, thus ensuring that the employee remains eligible for the security option deduction.

In particular, new subsection 110(1.7) provides that, where there is a reduction in the exercise price under an employee security option and the conditions in subsection 110(1.8) are satisfied, the employee is deemed to have disposed of the rights under the option immediately before the reduction and to have acquired the amended rights immediately thereafter as consideration for the disposition.

New subsection 110(1.8) sets out two conditions that must be satisfied in order for new subsection 110(1.7) to apply.

- First, the employee would not qualify for the security option deduction if the option were exercised immediately after the exercise price reduction (and subsection 110(1.7) were disregarded).

- Second, the employee would have been eligible for the deduction had there, in fact, been an exchange of options and the employee exercised the option immediately after the exchange.

These conditions ensure that the provisions of subsection 110(1.7) apply only where an otherwise disqualifying reduction in the exercise price under an employee security option could have been effected by way of an exchange of options without so disqualifying the employee.

Example

Pierre is granted an option to acquire ten shares of Company A at an exercise price of $100 a share, which is the FMV of such a share at that time. After a downturn of the business, the Company amends the option to reduce the exercise price to $30 a share, which is the new FMV of such a share.

Results:

Without the benefit of subsection 110(1.7), paragraph 110(1)(d) would require that the exercise price under the option at the time of exercise be no less than the FMV of the underlying share at the time the option was granted. Since the exercise price of $30 would be less than the FMV of $100 at the time the option was issued, this condition would not be met and Pierre would not be eligible for the security option deduction.

If the reduction had been effected by way of an exchange of options, there would have been no increase in the net benefit associated with the option (i.e., the difference between the FMV of the shares under the "new option" and the "new exercise price" ($300 - $300 = $0) would have been no greater than the difference between the FMV of the shares under the "old option" and the "old exercise price" ($300 - $1,000 = $0)). Thus, the exchange would have been an exchange to which subsection 7(1.4) applied.

If Pierre had exercised the new option immediately after the exchange, paragraph 110(1)(d) would have required that the following exercise price tests be met:

- *The exercise price under the old option at the time it was disposed of would have to be not less than the FMV of the underlying shares when the option was granted. Since the exercise price of $100 was equal to the FMV at the date of grant, this condition would have been met.*

- *The exercise price under the new option at the time of exercise would have to be not less than the exercise price set when the new option was acquired. Since Pierre would have paid $30 a share on exercise, which was the exercise price established*

> *when the new option was acquired, this condition would have been met.*

> *Thus, if the reduction had been effected by way of an exchange and Pierre had exercised the option immediately after the exchange, he would have been eligible for the security option deduction.*

> *Since the requirements of subsection 110(1.8) are satisfied, subsection 110(1.7) applies to deem the reduction to have been effected by way of an exchange. Consequently, the reduction will not disqualify Pierre from claiming the stock option deduction.*

New subsections 110(1.7) and (1.8) apply to exercise price reductions that occur after 1998.

Extended deadline for deferral election

Where certain conditions are satisfied, subsection 7(8) of the Act allows an employee to defer taxation of a security option benefit to the year in which the employee disposes of the security. One condition is that the employee be eligible to claim the deduction under paragraph 110(1)(*d*) in respect of the benefit. Another condition is that the employee files an election to defer before January 16th of the year following the year in which the option is exercised (or before August 14, 2001 for securities acquired in 2000).

The coming-into-force provisions for subsections 110(1.7) and (1.8) extend the deferral election deadline for securities which are acquired before this legislation receives Royal Assent, and which become qualified for the deduction under paragraph 110(1)(*d*) only by reason of amended subsection 110(1.7), to the later of

- the election deadline that would otherwise apply, and
- the day that is 60 days after Royal Assent.

Clause 47

Charitable Donations Deduction

ITA
110.1

Section 110.1 of the Act provides a deduction in computing taxable income in respect of gifts made by corporations to registered charities and to certain other entities. Section 110.1 is amended consequential to the addition of new subsections 248(30) to (33) of the Act. Generally, those subsections clarify the circumstances under which a transfer of property will be considered a gift notwithstanding that the transferor may be entitled to receive an advantage or benefit in respect of the property. New subsection 248(30) generally provides that the "eligible amount" of the gift is the excess of the fair market value of a property transferred by way of gift over the value of the advantage or benefit, if any, to which the transferor is entitled. For additional information, see the commentary to new subsections 248(30) to (33).

Deduction for Gifts

ITA
110.1(1)

Paragraphs 110.1(1)(*a*) to (*d*) of the Act provide, respectively, for the deduction by a corporation of amounts in respect of "charitable gifts", "gifts to Her Majesty", "gifts to institutions" and "ecological gifts". The amount deductible by the corporation is generally the fair market value of the gift. These paragraphs are amended, consequential to the addition of new subsection 248(30) of the Act, to provide that the amount deductible by the corporation is generally the "eligible amount" of a gift.

Paragraph 110.1(1)(*d*) is also amended to clarify its application to "real servitudes" under the *Civil Code of Quebec*.

The amendments to subsection 110.1(1) apply in respect of gifts made after Announcement Date.

Proof of Gift

ITA
110.1(2)

Subsection 110.1(2) of the Act provides that a corporation may not deduct an amount in respect of a gift unless the gift is evidenced by a receipt containing prescribed information. The subsection is amended, concurrently with subsection 110.1(1) of the Act, to refer to the "eligible amount" of a gift.

It is proposed that subsections 3501(1), (1.1) and (6) of the Regulations be amended to provide that every official receipt issued by a registered organization in respect of a gift contain, in addition to the information already prescribed, a description and the amount of the advantage, if any, and the eligible amount of the gift.

For additional details, see the commentary to new subsections 248(30) and (31) of the Act regarding the eligible amount and the amount of the advantage in respect of a gift.

These amendments to subsection 110.1(2) of the Act and subsections 3501(1), (1.1) and (6) of the Regulations are to be effective in respect of gifts made after Announcement Date.

Gifts of Capital Property

ITA
110.1(2.1) and (3)

Subsection 110.1(3) of the Act provides that, if a corporation donates capital property to a charity, it may designate a value between the adjusted cost base and the fair market value of the donated property to be treated both as the proceeds of disposition for the purpose of calculating its capital gain and the amount of the gift for the purpose of the deduction allowed for charitable donations under subsection 110.1(1) of the Act.

Subsection 110.1(3) is restructured as new subsection 110.1(2.1) and revised subsection 110.1(3). New subsection 110.1(2.1) describes the circumstances under which amended subsection 110.1(3), which remain generally unchanged, will apply.

Amended subsection 110.1(3) provides for the amount that may be designated by the corporation. As with the former provision, the amount designated is considered to be the corporation's proceeds of disposition of the gift. The subsection also continues to provide that the amount designated is treated as the fair market value of the property transferred by way of gift. However, under the amended version, this is for the purpose of new subsection 248(30) of the Act instead of for subsection 110.1(1). New subsection 248(30) generally provides that the "eligible amount" of a gift is the excess of the fair market value of a property transferred by way of gift over the value of the advantage or benefit, if any, to which the transferor is entitled. The "eligible amount" is relevant to the determination of the amount deductible under subsection 110.1(1) by the corporation.

Finally, amended subsection 110.1(3) allows a corporation to reduce the amount of recaptured depreciation that might otherwise be calculated in respect of a gift of depreciable property, with a corresponding reduction to the eligible amount deductible under subsection 110.1(1) in respect of the gift. However, the designated amount may not be lower than the amount of any actual proceeds of disposition in respect of the property (or, more specifically, the amount of the advantage in respect of the gift, as defined in new subsection 248(31) of the Act).

In particular, the amount designated by the corporation in respect of the property transferred may not exceed the fair market value of the property otherwise determined, and may not be less than the greater of

- the amount of the advantage, if any, in respect of the gift, and

- the adjusted cost base of the property or, if the property is depreciable property of the corporation, the undepreciated capital cost of the class of the property at the end of the corporation's taxation year (determined without reference to the proceeds of disposition designated in respect of the property).

See also the example in the commentary to subsections 118.1(5.4) and (6) of the Act, which apply similarly to individuals as do subsections 110.1(2.1) and (3) to corporations.

Subsections 110.1(2.1) and (3) of the Act (as amended) generally apply in respect of gifts made after 1999. For additional details regarding the eligible amount and the amount of the advantage in respect of a gift, see the commentary to new subsections 248(30) and (31) of the Act.

Gifts Made by a Partnership

ITA
110.1(4)

Subsection 110.1(4) of the Act allows the attribution of gifts made by a partnership to its corporate members, according to each member's share in the partnership. Subsection 110.1(4) is amended, consequential to the addition of new subsection 248(30) of the Act, in respect of gifts made by a partnership after Announcement Date, to refer to the "eligible amount" of a gift made because of a corporation's membership in a partnership.

Ecological Gifts

ITA
110.1(5)(*b*)

Subsection 110.1(5) of the Act provides that the fair market value of a gift of ecologically sensitive land (or a covenant, easement or servitude in respect of ecologically sensitive land) is deemed to be the amount determined by the Minister of the Environment. Paragraph 110.1(5)(*b*) provides that the amount so determined in respect of a covenant, easement or servitude will not be considered to be less than the decrease in value of the subject land that resulted from the making of the gift.

Paragraph 110.1(5)(*b*) is amended to clarify its application to "real servitudes" under the *Civil Code of Quebec*.

This amendment applies to gifts made after Announcement Date.

Clause 48

Lifetime Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules that apply in calculating an individual's entitlement to the lifetime capital gains exemption.

Related Persons, etc.

ITA
110.6(14)

Subsection 110.6(14) of the Act provides certain rules that apply for the purposes of the definition "qualified small business corporation share" in subsection 110.6(1) and the capital gains exemption in respect of such shares. This subsection is amended to add new paragraph 110.6(14)(*d*.1).

New paragraph 110.6(14)(*d*.1) deems a person who is a member of a partnership that is a member of another partnership (a lower-tiered partnership) to be a member of the lower-tiered partnership. This amendment will permit such a taxpayer to have access to the deduction for taxable capital gains arising on the disposition of a qualified small business corporation share by the lower-tiered partnership.

This amendment applies to dispositions that occur after Announcement Date and, if a taxpayer so elects in writing and files the election with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year in which this amendment is assented to, to dispositions made by the taxpayer after 1999.

Clause 49

Loss Carryovers

ITA
111

Section 111 of the Act establishes the extent to which a taxpayer is permitted to deduct, in computing taxable income for a taxation year, losses of other years.

Net Capital Losses

ITA
111(1.1)

Subsection 111(1.1) of the Act determines the amount that a taxpayer may deduct in respect of a net capital loss claimed under paragraph 111(1)(*b*). The 2000 Budget and the 2000 Economic Statement provided for the reduction of the capital gains inclusion rate from 3/4 to 2/3 and then to 1/2, respectively. This reduction in the inclusion rate gave rise to changes to the adjusting factors in subsection 111(1.1). An additional amendment is made to subsection 111(1.1) to permit the Minister of National Revenue to determine a reasonable amount of deduction in respect of net capital loss carryovers where the other rules in that subsection produce inappropriate results.

The amendment to subsection 111(1.1) applies to the 2000 and subsequent taxation years.

Definitions

ITA
111(8)

Subsection 111(8) of the Act contains definitions that apply for the purposes of section 111.

"pre-1986 capital loss balance"

An individual's "pre-1986 capital loss balance" for a taxation year is relevant for the purpose of paragraph 111(1.1)(*b*) and represents the individual's unused pre-1986 capital losses that the individual can deduct, to a maximum of $2,000 per year, from income other than capital gains of the individual. The reference in the description of C in the definition to "taxation years that end before 1988 or after October 17, 2000" is corrected to refer to "taxation years that end before 1988 or begin after October 17, 2000". The amended definition is applicable to the 2000 and subsequent taxation years.

Clause 50

Certificates for Dispositions

ITA
116(5.2)

Section 116 of the Act sets out rules that apply when a non-resident person disposes of any of certain types of property. Subsection 116(5.2) allows a non-resident vendor to obtain what is commonly known as a "clearance certificate" in respect of the disposition or proposed disposition of, among other things, depreciable property that is a taxable Canadian property. Subsection 116(5.2) is amended to include among the types of property to which it applies eligible capital property that is a taxable Canadian property. This amendment applies after December 23, 1998, which is when the definition "taxable Canadian property" in subsection 248(1) of the Act first included eligible capital property used in carrying on a business in Canada.

Excluded Property – Authorized Foreign Banks

ITA
116(6)(*f*)

Subsection 116(6) of the Act defines "excluded property" for the purposes of section 116 of the Act. Paragraph 116(6)(*f*) defines the "excluded property" of an authorized foreign bank.

Paragraph 116(6)(*f*) currently treats as an excluded property any property of an authorized foreign bank that is used or held in the bank's "Canadian banking business" (defined in subsection 248(1) of the Act). The paragraph is amended to treat as excluded property all of the property of an authorized foreign bank that carries on a Canadian banking business. As a result, the treatment of authorized foreign banks will in this respect be comparable to the treatment of non-resident insurers.

This amendment applies to dispositions that occur after June 27, 1999.

Clause 51

Charitable Donations Tax Credit

ITA
118.1

Section 118.1 of the Act provides for a charitable donations tax credit to individuals in respect of gifts made to registered charities and to certain other entities.

The amendments to section 118.1, described below, are made consequential to the addition of new subsections 248(30) to (33) of the Act. Generally, those subsections clarify the circumstances under which a transfer of property will be considered a gift notwithstanding that the donor may be entitled to receive an advantage or benefit in respect of the property. New subsection 248(30) generally provides that the "eligible amount" of the gift is the excess of the fair market value of a property transferred by way of gift over the value of the advantage or benefit, if any, to which the transferor is entitled. For additional information, see the commentary to new subsections 248(30) to (33).

Definitions

ITA
118.1(1)

Subsection 118.1(1) of the Act provides definitions of the terms "total charitable gifts", "total Crown gifts", "total cultural gifts" and "total ecological gifts". These definitions apply for the purpose of the tax credit available under subsection 118.1(3) of the Act to individuals who make such gifts. The amount of a gift that is eligible for a tax credit is, generally, the fair market value of the property disposed of by the individual in the making of the gift.

The definitions "total charitable gifts", "total Crown gifts", "total cultural gifts" and "total ecological gifts" in subsection 118.1(1) are amended, consequential to the addition of new subsection 248(30) of the Act, to provide that the amount that qualifies for the credit under subsection 118.1(3) is the "eligible amount" of a gift.

The definition "total ecological gifts" is also amended to clarify its application to "real servitudes" under the *Civil Code of Quebec*.

The amendments to subsection 118.1(1) apply in respect of gifts made after Announcement Date.

Proof of Gift

ITA
118.1(2)

Subsection 118.1(2) of the Act provides that an amount in respect of a gift by an individual may not be included in the amount eligible for a tax credit under subsection 118.1(3) unless the gift is evidenced by a receipt containing prescribed information. Subsection 118.1(2) is amended concurrently with subsection 118.1(1), to refer to the "eligible amount" of a gift.

It is proposed that subsections 3501(1), (1.1) and (6) of the Regulations be amended to provide that every official receipt issued by a registered organization in respect of a gift contain, in addition to the information already prescribed, a description of and the amount of the advantage, if any, and the eligible amount of the gift.

For additional details, see the commentary to new subsections 248(30) and (31) of the Act regarding the eligible amount and the amount of the advantage in respect of a gift.

The amendments to subsection 118.1(2) of the Act and subsections 3501(1), (1.1) and (6) of the Regulations are to be effective in respect of gifts made after Announcement Date.

Gift of Capital Property

ITA
118.1(5.4) and (6)

Subsection 118.1(6) of the Act provides that, if an individual donates capital property to a charity, the individual may designate a value between the adjusted cost base and the fair market value of the donated property to be treated both as the proceeds of disposition for the purpose of calculating the individual's capital gain and the amount of the gift for the purpose of calculating the tax credit allowed for charitable donations under subsection 118.1(3) of the Act.

Subsection 118.1(6) is restructured as new subsection 118.1(5.4) and revised subsection 118.1(6). New subsection 118.1(5.4) describes the circumstances under which amended subsection 118.1(6), which remain generally unchanged, will apply.

Amended subsection 118.1(6) provides for the amount that may be designated by the individual. As with the former provision, the amount designated is deemed to be the individual's proceeds of disposition of the gift. The provision also continues to provide that the amount designated is treated as the fair market value of the property transferred by way of gift. However, under the amended version, this is for the purpose of new subsection 248(30) of the Act (changed from subsection 118.1(1) of the Act). New subsection 248(30) generally provides that the "eligible amount" of the gift is the excess of the fair market value of a property transferred by way of gift over the value of the advantage or benefit, if any, to which the transferor is entitled. The "eligible amount" is relevant to the determination of the tax credit deductible by the individual under subsection 118.1(3).

Finally, amended subsection 118.1(6) effectively allows an individual to reduce the amount of recaptured depreciation that might otherwise be calculated in respect of a gift of depreciable property, with a corresponding reduction to the eligible amount deductible in respect of the gift under subsection 118.1(6). However, the designated amount may not be lower than the amount of any actual proceeds of disposition in respect of the property (or, more specifically, the amount of the advantage in respect of the gift, as defined under new subsection 248(31) of the Act).

In particular, the amount designated by the individual in respect of the property transferred may not exceed the fair market value of the property otherwise determined, and may not be less than the greater of

- the amount of the advantage, if any, in respect of the gift, and
- the adjusted cost base of the property or, if the property is depreciable property of the individual, the undepreciated capital cost of the class of the property at the end of the individual's taxation year (determined without reference to the proceeds of disposition designated in respect of the property).

Subsections 118.1(5.4) and (6) (as amended) generally apply in respect of gifts made after 1999. For additional details regarding the eligible amount and the amount of the advantage in respect of a gift, see the commentary to new subsections 248(30) and (31).

Example

Mr. Adams transfers a rental property with a fair market value of $200,000 to a registered charity, in exchange for proceeds of disposition of $95,000. The original cost to Mr. Adams when he purchased the property in 1985 was $65,000. The rental property is the only depreciable property in its class, with an undepreciated capital cost balance before the transfer of $45,000.

Assuming that the transfer qualifies as a gift (see the commentary to subsections 248(30) to (32)), Mr. Adams may designate any amount between $95,000 and $200,000 as the proceeds of disposition for the gift. Mr. Adams could have designated an amount as low $45,000, if he had received a lesser amount in actual proceeds from the charity.

Mr. Adams decides to designate $150,000 as its proceeds of disposition. The taxable gain to Mr. Adams on the transfer can therefore be allocated as follows:

Designated proceeds		*$150,000*
Adjusted cost base (original cost)	*65,000*	*65,000*
Capital Gain		*85,000*
Taxable Capital Gain		*42,500*
Undepreciated Capital Cost	*45,000*	
Recaptured depreciation		*20,000*
Total Income Inclusion		*$ 62,500*

The eligible amount of the gift is calculated as follows:

Designated proceeds	*$150,000*
Amount of advantage (consideration)	*95,000*
Eligible amount of the gift	*55,000*

Gifts of Art

ITA
118.1(7)(*d*) and 118.1(7.1)(*d*)

Subsection 118.1(7) of the Act provides that, if an artist donates artwork created by the artist and held in the artist's inventory, the artist may designate a value between the cost amount and the fair market value of the artwork to be treated both as the proceeds of disposition for the purpose of calculating the artist's income and the amount of the gift for the purpose of calculating the tax credit allowed for charitable donations under subsection 118.1(3) of the Act.

If the artwork is certified as a cultural gift, as described in subsection 118.1(1) of the Act, subsection 118.1(7.1) of the Act applies instead of subsection 118.1(7). Under subsection 118.1(7.1), the artist is treated as having received proceeds of disposition equal to the cost amount to the artist of the work of art for the purpose of calculating the artist's income, but the fair market value of the artwork is not affected. This means that the artist is entitled to a credit based on the value of the donation, but that the artist recognizes neither a profit nor a loss on the disposition of the work of art in computing income from a business for income tax purposes.

Paragraphs 118.1(7)(*d*) and (7.1)(*d*) are amended consequential to the addition of subsections 248(30) and (31) of the Act. Amended paragraph 118.1(7.1)(*d*) generally provides that the artist's proceeds of disposition from a gift of cultural property that was created by the artist and held as inventory may not be lower than the amount of any actual proceeds of disposition in respect of the property (or, more specifically, the amount of the advantage in respect of the gift, as defined under new subsection 248(31)). In particular, the amount that may be designated by the artist must be the greater of the cost amount of the work of art and the amount of the advantage in respect of the gift. As a result, the artist will have business income from the disposition if the amount of the advantage in respect of the gift exceeds the cost amount to the artist of the work of art.

For gifts from an artist's inventory that are not certified cultural property, amended paragraph 118.1(7)(*d*) provides that the amount designated in the artist's return of income is deemed to be the artist's proceeds of disposition. The provision also continues to provide that the amount designated is treated as the fair market value of the property transferred by way of gift. However, under the amended version, this is for the purpose of new subsection 248(30) (changed from subsection 118.1(1)). New subsection 248(30) generally provides that the "eligible amount" of the gift is the excess of the fair market value of a property transferred by way of gift over the value of the advantage or benefit, if any, to which the transferor is entitled. The "eligible amount" is relevant to the determination of the tax credit deductible by the individual under subsection 118.1(3).

The amount designated in the artist's return of income in respect of the property transferred may not exceed the fair market value of the property otherwise determined, and may not be less than the greater of

- the amount of the advantage, if any, in respect of the gift,and
- the cost amount to the artist of the work of art.

As a result, the artist will have business income from the disposition to the extent that the amount of the advantage in respect of the gift (or some other amount designated in the artist's return of income, if greater) exceeds the cost amount to the artist of the work of art.

For additional details regarding the eligible amount and the amount of the advantage in respect of a gift, see the commentary to new subsections 248(30) and (31) of the Act.

The amendments to paragraphs 118.1(7)(*d*) and (7.1)(*d*) apply in respect of gifts made after Announcement Date.

Gifts Made by Partnership

ITA
118.1(8)

Subsection 118.1(8) of the Act allows the attribution of gifts made by a partnership to its individual members, according to each member's share in the partnership. Subsection 118.1(8) is amended consequential to the addition of new subsection 248(30) of the Act, to refer to the "eligible amount" of a gift made because of an individual's membership in a partnership.

The amendment applies in respect of gifts made by a partnership after Announcement Date.

Non-qualifying Securities

ITA
118.1(13)(*b*) and (*c*)

Subsection 118.1(13) of the Act provides that, if an individual makes a gift of a "non-qualifying security" (defined in subsection 118.1(18) of the Act), that gift will be ignored for the purpose of the charitable donations tax credit.

Paragraphs 118.1(13)(*b*) and (*c*) concern the amount to be included in a taxpayer's "total charitable gifts" or "total Crown gifts" (defined in subsection 118.1(1) of the Act) for the taxation year in which a security ceases to be a "non-qualifying security" or the donee disposes of a non-qualifying security. If either of these events occurs within five years of the actual donation of the non-qualifying security by a taxpayer, the taxpayer will be treated as having made a gift at that later time. The fair market value of this deemed gift is considered to be the lesser of two amounts. The first amount is the fair market value of the security at the time that it was actually donated. (Note that this amount may have been designated by the taxpayer as a lower amount than the actual fair market value if an election were made under subsection 118.1(6) of the Act for the taxation year of the actual donation.) The second amount is

- if the security ceased at the later time to be a non-qualifying security, the fair market value of the security at that later time, or

- if the security was disposed of by the donee at that later time, the fair market value of the consideration received by the donee.

Amendments to paragraphs 118.1(13)(*b*) and (*c*) are to provide language complementary to the amendment of the definitions "total charitable gifts" and "total Crown gifts" in subsection 118.1(1). The amendments apply to gifts actually made after Announcement Date.

Clause 52

Medical Expense Tax Credit

ITA
118.2

Section 118.2 of the Act provides rules for determining the amount that may be claimed, as a tax credit, in respect of an individual's medical expenses.

ITA
118.2(1)

As a general rule, qualifying medical expenses must be paid within any 12-month period that ends in the taxation year for which they are claimed; however, in the event of the death of an individual, the time period is extended to any 24-month period that includes the date of the individual's death. The amendment to the description of B in subsection 118.2(1) clarifies that the extended 24-month period applies in respect of medical expenses paid for a deceased person and included in the claimant's medical expense tax credit and is not restricted to circumstances where the claimant has died. This amendment applies to the 2001 and subsequent taxation years.

ITA
118.2(2)(*c*), (*d*), (*e*), (*g*), and (*h*)

The eligibility of certain expenses to the medical expense tax credit is conditional on a medical practitioner's certification. Paragraphs 118.2)(*c*), (*d*), (*e*), (*g*), and (*h*) are amended to clarify that such a certification has to be in writing. These amendments apply after Announcement Date.

Clause 53

Tax Credit for Mental or Physical Impairment

ITA
118.3(2)(*a*)

Paragraph 118.3(2)(*a*) of the French version of the Act is amended to include a phrase that was inadvertently deleted from the provision when it was last amended. This amendment applies to the 2001 and subsequent taxation years.

Clause 54

Tuition Credit

ITA
118.5(1)(*a*)(iii)

Subsection 118.5(1) of the Act provides a tax credit in respect of tuition fees paid to certain educational institutions. Subparagraph 118.5(1)(*a*)(iii) provides that an amount paid on behalf of an individual by the individual's employer is not eligible for the credit unless the amount is required to be included in computing the individual's income. Subparagraph 118.5(1)(*a*)(iii) is amended, applicable on Royal Assent, to clarify that an amount paid by the individual, for which the individual is reimbursed by the individual's employer, is also not eligible for the credit unless the reimbursement is required to be included in computing the individual's income.

Clause 55

Education Tax Credit

ITA
118.6

Section 118.6 of the Act contains rules governing the education tax credit.

Definitions

ITA
118.6(1)

Subsection 118.6(1) of the Act defines the expression "designated educational institution", which is relevant for the purposes of the child care expense and attendant care expense deductions and the tuition fee and education tax credits. Generally speaking, a designated educational institution is an institution that provides post-secondary education, an institution certified by the Minister of Human Resources Development that furnishes or improves skills in an occupation, or a foreign university. This amendment to subparagraph (*a*)(i) of that definition, applicable to the 1998 and subsequent taxation years, is consequential on the change in the name of the Quebec statute under which financial assistance is provided to students as well as the change in the name of the responsible Quebec ministry.

A similar amendment is made to subparagraph (*a*)(ii) of the definition "qualifying educational program".

Disabled Students

ITA
118.6(3)(*b*)

Subsection 118.6(3) of the Act removes the requirement that a student be enrolled on a full-time basis to benefit from the full-time education tax credit if the student is eligible for the disability tax credit or cannot be enrolled on a full-time basis because of the student's mental or physical impairment, as certified in writing by a medical doctor or another health professional referred to in that subsection. Paragraph 118.6(3)(*b*) is amended to include a written certification by an authorized speech-language pathologist with respect to a severe and prolonged speech impairment.

This amendment applies to certifications made after October 17, 2000.

Clause 56

Unused Tuition and Education Tax Credit

ITA
118.61(1) and (2)(*b*)

Subsection 118.61(1) of the Act provides for the calculation of a student's unused tuition and education tax credits at the end of a taxation year that may be carried forward to future taxation years for use by the student. The amount of the carry-forward that is deductible for the current year is set out in subsection 118.61(2).

Paragraph 118.61(2)(*b*) and the description of C in subsection 118.61(1) are amended, applicable to the 2002 and subsequent taxation years, to ensure that the calculation of the student's unused tax credits are compatible with the ordering in section 118.92 for the claiming of non-refundable credits. These amendments also ensure that the wording contained in this section is compatible with the wording used in section 118.8 (in particular, subparagraph (*b*)(ii) in the description of C and the description of B in paragraph 118.81(1)(*a*)).

Clause 57

Minimum Tax Carry-Over

ITA
120.2(3)(*b*)

Section 120.2 of the Act allows an individual to apply additional taxes, imposed for a given year under the minimum tax in section 127.5 of the Act, against the individual's ordinary Part I tax liability for following years. Paragraph 120.2(3)(*b*) is amended to remove the reference in that paragraph to subsection 120.4(2). This amendment ensures that an individual's additional tax in respect of the minimum tax does not include the special 29% tax imposed under section 120.4 on certain passive income of minors.

This amendment applies to the 2000 and subsequent taxation years.

Clause 58

Lump-sum Payments

ITA
120.31(3)(*b*)

Section 120.31 of the Act provides for the calculation of the tax payable on certain lump-sum payments. The amount of the tax is equal to the total of the additional taxes that would be payable for each relevant taxation year if the portion of the lump-sum payment that relates to that preceding year were added to the individual's taxable income for that year.

A notional amount of interest (using the rate of interest on tax refunds applicable to the relevant period) is added to the additional tax to take into account the fact that the calculation of the tax on the lump-sum payment should reflect not only the additional tax that would have been payable had the payment been received on an on-going basis, but also the fact that this additional tax was not paid during those preceding years.

The amendment to paragraph 120.31(3)(*b*) clarifies that the notional amount of interest is calculated on the amount of the additional tax for each relevant previous year and not on the whole tax payable for that year. This amendment applies to the 1995 and subsequent taxation years.

Clause 59

Tax on Split Income

ITA
120.4

Section 120.4 of the Act provides a special 29% tax applicable to certain passive income of individuals under the age of 18. These tax on split income rules were first proposed in the 1999 Budget Plan. At the time, the government indicated that it "would monitor the effectiveness of this targeted measure, and may take appropriate action if new income-splitting techniques develop".

Definitions

ITA
120.4(1)

"split income"

The expression "split income" describes the type of income to which this measure applies.

Among other things, split income of an individual includes all amounts (other than excluded amounts) required to be included in the individual's income in respect of partnership or trust income if the source of the income is the provision of goods or services by the partnership or trust to, or in support of, a business carried on by

- a person who is related to the individual,
- a corporation of which a person who is related to the individual is a specified shareholder, or
- a professional corporation of which a person related to the individual is a shareholder.

The phrase "goods or services" in the English version of subparagraph (*b*)(ii) and clause (*c*)(ii)(C) in the definition "split income" is replaced, for fiscal periods and taxation years that begin after Announcement Date, by the phrase "property or services". This ensures that the split income rules will apply to income from property such as rental income. Also see the commentary to subsection 160(1.2) of the Act, which is amended consequential to this amendment.

Clause 60

Overseas Employment Tax Credit

ITA
122.3

Section 122.3 of the Act provides an "overseas employment tax credit" to individuals resident in Canada who are employed for at least six consecutive months in a foreign country by a specified employer in respect of certain enumerated activities.

Subsection 122.3(1.1), which at present limits access to the tax credit in one set of circumstances, is amended so that the credit is also unavailable in another situation. New paragraph 122.3(1.1)(*b*) denies an individual the benefit of the credit if, at any time in the qualifying period, the services of the individual are provided to a firm with which the employer does not deal at arm's length, and less than 10% of the fair market value of all the interests in the firm are held by persons resident in Canada. The set of circumstances currently described in paragraphs 122.3(1.1)(*a*), (*b*) and (*c*) is contained in amended paragraph 122.3(1.1)(*a*).

Subsection 122.3(1) is amended to ensure that the term "qualifying period" applies to subsection 122.3(1.1), as well as to subsection 122.3(1).

These amendments to subsections 122.3(1) and (1.1) apply to taxation years that begin after this Act is assented to.

Clause 61

Small Business Deduction

ITA
125

Section 125 of the Act provides for a corporate tax reduction (called the "small business deduction") in respect of income of a Canadian-controlled private corporation (CCPC) from an active business carried on by it in Canada.

ITA
125(1)

Under subsection 125(1) of the Act, a CCPC's small business deduction for a taxation year is calculated as 16% of the least of three amounts. One of these, set out in paragraph 125(1)(*b*), is the amount by which the corporation's taxable income for the year exceeds income that has supported a foreign tax credit (FTC) or that is statutorily exempt from tax. The amount of income that has supported an FTC is determined by multiplying the corporation's FTCs for the year (subject to certain adjustments) by a factor that reflects an assumed rate of tax. For FTCs in respect of foreign non-business income, the factor is currently 10/3, reflecting an assumed tax rate of 30%. For business-income FTCs, the factor is currently 10/4, which reflects an assumed tax rate of 40%.

Subparagraphs 125(1)(*b*)(i) and (ii) are amended to adjust these factors, as part of a series of amendments reflecting recent and planned reductions in income tax rates. The factor for non-business income FTCs will become 4; the factor for business-income FTCs will become 3. These imply assumed tax rates of 25% and 33.3%, respectively. These amendments apply to the 2003 and subsequent taxation years.

ITA
125(5.1)

A corporation's entitlement to the small business deduction for a particular taxation year is determined by reference to, among other things, the "business limit" of the corporation for the particular year. In broad terms, subsection 125(5.1) of the Act reduces the business limit of a corporation if tax under Part I.3 of the Act was payable by the corporation for its preceding taxation year. If the corporation is associated with one or more other corporations in the particular year, the provision takes into account the Part I.3 tax payable by it and those other corporations, in each case for their last taxation years that ended in the preceding calendar year.

Subsection 125(5.1) is amended to respond better to cases in which a corporation is associated with more, fewer or different corporations in one taxation year than in the past. Specifically, the description of B in the formula in the subsection – a description that in effect refers to an amount of tax under Part I.3 – will take one of four forms, depending on the corporation's associations in the current and the preceding taxation year:

- if the corporation is not associated with any other corporation in the current year, and was not associated with any other corporation in the preceding taxation year, the description of B is based on the corporation's Part I.3 tax for the preceding taxation year;

- if the corporation is not associated with any other corporation in the current year, but was so associated in the preceding taxation year, the description of B is based on the corporation's Part I.3 tax for the current year;

- if the corporation is associated in the current year with one or more other corporations, and in the preceding taxation year it was associated with all of those corporations and no others, the description of B is based on the total Part I.3 tax payable by the corporation itself and by all of those other corporations, in each case for its last taxation year that ended in the preceding calendar year; and

- if the corporation is associated with one or more corporations in the current year, but in the preceding taxation year was not associated with all of those corporations or was associated with some other corporation as well, the description of B is the product of a formula that looks to the total taxable capital employed in Canada of the corporation itself and all the corporations with which it is associated in the current year, in each case for its last taxation year that ended in the preceding calendar year.

This amendment applies to taxation years that begin after Announcement Date.

Clause 62

Manufacturing and Processing Profits Deduction

ITA
125.1

Section 125.1 of the Act provides a reduced rate of corporate tax on Canadian manufacturing and processing profits.

Definitions

ITA
125.1(3)

Subsection 125.1(3) of the Act defines the expression "manufacturing or processing" for the purpose of section 125.1. Paragraph 125.1(3)(*l*) of this definition excludes any manufacturing or processing of goods for sale or lease.

The French version of subparagraphs (*l*)(i) and (ii) of the definition are amended to replace the word "*articles*" by the word "*marchandises*" in order to be consistent with the terminology used in the opening words of paragraph (*l*) of the definition. A similar amendment is made to the French version of the definition "Canadian manufacturing and processing profits" in subsection 125.1(3).

These amendments apply on Royal Assent.

Clause 63

Canadian Film or Video Production Tax Credit

ITA
125.4

Section 125.4 of the Act sets out the rules that apply for the purpose of computing the Canadian film or video production tax credit. Generally, this tax credit is available at a rate of 25% of qualified labour expenditures incurred by a qualified corporation for a production certified by the Minister of Canadian Heritage as a Canadian film or video production.

Definitions

ITA
125.4(1)

"Canadian film or video production certificate"

Subsection 125.4(1) of the Act provides definitions that apply for the purpose of section 125.4. A qualifying corporation must file a Canadian film or video production certificate with its tax return for a taxation year in which it claims a Canadian film or video production tax credit in respect of the production. A "Canadian film or video production certificate", as defined in subsection 125.4(1), is issued by the Minister of Canadian Heritage. The definition is amended to provide that that Minister will also certify that the public funding of the production would not be contrary to public policy and that, generally, a qualifying corporation or a related taxable Canadian corporation will retain an acceptable share of revenues from the exploitation of the production in non-Canadian markets. The Minister of Canadian Heritage will issue guidelines as to how these criteria can be met.

This amendment applies in respect of Canadian film or video productions for which certificates are issued by the Minister of Canadian Heritage after Announcement Date.

Guidelines

ITA
125.4(7)

New subsection 125.4(7) of the Act, which applies in respect of Canadian film or video productions for which certificates are issued by the Minister of Canadian Heritage after Announcement Date, requires the Minister of Canadian Heritage to issue guidelines respecting the circumstances under which new conditions in the definition "Canadian film or video production certificate" in subsection 125.4(1) of the Act are met. For further details, see the commentary for that definition.

Clause 64

Foreign Tax Credit – Dispositions Ignored

ITA
126(4.4)

Subsection 126(4.4) of the Act directs that certain dispositions and acquisitions of property be ignored for the purposes of the foreign tax credit limitations in subsections 126(4.1) and (4.2) and the definition of "economic profit" in subsection 126(7). As a consequence of the restructuring of section 132.2 of the Act, the reference in paragraph 126(4.4)(*a*) to paragraph 132.2(1)(*f*) is replaced by a reference to section 132.2.

This amendment applies to dispositions and acquisitions that occur after 1998 except that, in applying paragraph 126(4.4)(*a*) of the Act to dispositions and acquisitions that occur before June 28, 1999, that paragraph is to be read without reference to subsections 10(12), 10(13), 14(14) and 14(15) of the Act.

Clause 65

UI Premium Tax Credit

ITA
126.1

Section 126.1 of the Act provides certain employers with a refundable tax credit to offset the increase in the employer's portion of 1993 unemployment insurance premiums.

This section has lapsed, and is repealed in respect of forms filed after the 90th day after Announcement Date.

Clause 66

Deductions in Computing Tax

ITA
127

Section 127 of the Act permits deductions in computing tax payable in respect of logging taxes, political contributions and investment tax credits.

Contributions to Registered Parties and Candidates

ITA
127(3)

Subsection 127(3) of the Act provides a tax credit to a taxpayer in respect of amounts contributed to a registered party or to a candidate. Subsection 127(3) is amended consequential to the addition of new subsection 248(31) of the Act, to provide that the amount of a contribution that is eligible for the political contributions tax credit is to be reduced by the amount of any advantage or benefit, as defined by subsection 248(31), to which the taxpayer is entitled in respect of the contribution.

It is proposed that subsections 2000(1) and (6) of the Regulations be amended to provide that every official receipt issued by a registered party in respect of a contribution contain, in addition to the information already prescribed, a description and the amount of the advantage, if any, in respect of the contribution, and the amount that is the excess of the contribution over the amount of the advantage.

For additional details, see the commentary to new subsection 248(31) regarding the amount of the advantage in respect of a contribution.

The amendments to subsection 127(3) of the Act and subsections 2000(1) and (6) of the Regulations are to be effective in respect of contributions made after Announcement Date.

Allocation of Amount Contributed Among Partners

ITA
127(4.2)

Subsection 127(4.2) of the Act allows the tax benefits of political contributions made by a partnership to be flowed through to its members. Subsection 127(4.2) is amended consequential to the amendment of subsection 127(3) of the Act, applicable to contributions made after Announcement Date, to provide the amount of a contribution that is eligible for a tax credit because of a taxpayer's membership in a partnership.

Investment Tax Credits

ITA
127(5) to (35)

Subsections 127(5) to (35) of the Act provide rules concerning investment tax credits.

Recapture of Investment Tax Credit

ITA
127(27)

Subsection 127(27) of the Act provides for the recapture of investment tax credits in respect of property used for scientific research and experimental development (SR&ED) where the property is sold or converted to commercial use. This recapture is effected by way of an addition to tax payable of an amount equal to the lesser of

- the amount that can reasonably be considered to have been included in the taxpayer's investment tax credit in respect of the particular property (i.e., the amount that is obtained by multiplying the amount of the qualified expenditure by the ITC rate that applied to that expenditure), and
- the amount that is obtained by multiplying the ITC rate (that applied to the qualified expenditure) by
    - the proceeds of disposition of the particular property (or of property that incorporates the particular property) if the property is disposed of to a person who deals at arm's length with the taxpayer. (See paragraph 127(27)(*e*) of the Act.)
    - in any other case, the fair market value of the particular property (or the other property) at the time of its conversion or disposition. (See paragraph 127(27)(*f*) of the Act.)

Concern has been expressed about the application of subsection 127(27) of the Act in the context of shared-use equipment, only 25% or 50% of the cost of which is a “qualified expenditure” under subsection 127(9) because of subsection 127(11.5) of the Act. This concern is illustrated by the following example.

Example:

- *Year 1: Taxpayer acquires shared-use equipment for $100. The ITC rate is 20% and the taxpayer claims an ITC for first term shared-use-equipment of $5 (20% x $25 [1/4 of its $100 cost under paragraph 127(11.5)(c)]).*

- *Year 2: Taxpayer claims an ITC for second term shared-use-equipment of $5 (20% x $25 [1/4 of its $100 cost under paragraph 127(11.5)(c)]).*

- *Year 4: Taxpayer sells the property for $80.*

- *Recapture under subsection 127(27):*

  $10 being the lesser of:

  - *$10 (20% x $100 x 50% because the property is second term shared-use-equipment), and*

  - *$16 (20% x $80 proceeds of disposition).*

However, in this example the $16 amount should be $8 given that only a portion (50%) of the cost of the second term shared-use-equipment is a qualified expenditure.

As well, the government is concerned that subsection 127(27) should apply where the disposition or conversion relates to property acquired pursuant to an expenditure that would have been a qualified expenditure incurred in a taxation year but for the application of the 180-day-unpaid-amount rule in subsection 127(26) of the Act.

To address these concerns, subsection 127(27) is amended in four respects.

First, paragraphs 127(27)(*b*) and (*c*) are amended to refer to the "cost, or a portion of the cost, of the particular property" instead of to the "cost of the particular property".

Second, paragraphs 127(27)(*b*) and (*c*) are amended to provide that the reference therein to a qualified expenditure included in a taxpayer's investment tax credit be read without reference to subsection 127(26) relating to unpaid amounts.

Third, consequential changes are made to the wording between paragraphs 127(27)(*d*) and (*e*) of the Act. In particular, the first of the two amounts in the "lesser of" formula is moved to new paragraph 127(27)(*e*). The second of these two amounts is described in amended paragraph 127(27)(*f*), which combines former paragraphs 127(27)(*e*) and (*f*).

Fourth, paragraph 127(27)(*f*), which combines former paragraphs 127(27) (*e*) and (*f*), is changed to account for circumstances where the property that is disposed of or converted is first term shared-use-equipment or second term shared-use-equipment.

These amendments apply to dispositions and conversions that occur after Announcement Date.

Clause 67

Labour-Sponsored Venture Capital Corporations

ITA
127.4

Section 127.4 of the Act provides for a tax credit for individuals (other that trusts) that acquire shares issued by a labour-sponsored venture capital corporation (LSVCC).

Definitions

ITA
127.4(1)

"approved share"

Subsection 127.4(2) of the Act allows an individual (other than a trust) a tax credit for the acquisition of an "approved share", which is defined in subsection 127.4(1) as, generally, a share issued by a prescribed LSVCC. LSVCCs prescribed for this purpose under section 6701 of the Regulations include LSVCCs registered under Part X.3 of the Act, as well as specified provincially registered LSVCCs. Paragraph (*b*) of the definition "approved share" excludes from the definition certain shares issued by a provincially-registered LSVCC that is not a federally-registered LSVCC. This exclusion applies only in the event that, at the time of the issue of the shares, no assistance is available in respect of the acquisition of such shares because of a suspension or termination of assistance to the LSVCC under the laws of every province in which the LSVCC is registered.

Paragraph (*b*) of the definition "approved share" is amended to provide that an approved share does not include a share issued by a provincially-registered LSVCC (that is not a federally-registered LSVCC) if, at the time of the issue, no province under the laws of which the corporation is an LSVCC that is a prescribed LSVCC provides assistance in respect of the acquisition of the share. This amendment is provided to have the definition "approved share" better reflect the policy that a federal income tax credit be available in respect of a share issued by a provincially-registered LSVCC (that is not a federally-registered LSVCC) only if a provincial income tax credit is also available in respect of the share.

Paragraph (*b*) of the definition will continue to apply if, at the time of the issue by such an LSVCC of a share, no assistance is available in respect of the acquisition of shares of the LSVCC because of a suspension or termination of assistance to the LSVCC under the laws of every province in which the LSVCC is registered.

Amended, paragraph (*b*) of the definition will also apply where there has not been a suspension or termination of assistance with respect to the issuance of the LSVCC's shares generally, but assistance is not available with respect to the acquisition of a particular share. For example, if under the laws of a province under which an LSVCC is a prescribed LSVCC, a taxpayer who acquires a share is not entitled to any assistance in respect of the acquisition either because of having reached the age of 65 years or because of the province of residence of the taxpayer, the share will not be treated as an approved share.

This amendment applies to the 2002 and subsequent taxation years.

Clause 68

Minimum Tax

ITA
127.52

Section 127.52 of the Act defines the "adjusted taxable income" of an individual for a taxation year for the purpose of determining the individual's minimum tax liability under Division E.1 of Part I of the Act.

ITA
127.52(1)(*d*)

Paragraph 127.52(1)(*d*) of the Act provides that in computing an individual's adjusted taxable income for minimum tax purposes, the total amount of capital gains and losses is to be taken into account. In some cases, because of subsection 104(21.6) of the Act (which in some cases deems a taxpayer to have realised a larger capital gain than was actually realised) more than the total amount of capital gains and losses would be taken into account. Excess capital gains are deemed by subsection 104(21.6) to have been realized in order that the inclusion rate for capital gains realized on property disposed of by a trust prior to February 28, 2000 is 3/4 and property disposed of by a trust after February 27, 2000 and before October 18, 2000 is 2/3. Paragraph 127.52(1)(*d*) is therefore amended to ensure that only the actual amount of the gain is included in computing the alternative minimum tax.

This change applies to the 2000 and subsequent taxation years.

Clause 69

Basic Minimum Tax Credit Determined

ITA
127.531

Section 127.51 of the Act provides for the calculation of an individual's minimum tax for a taxation year. An individual's minimum tax is determined by the formula:

$$A \times (B-C) - D$$

where

A is the appropriate percentage (16%);

B is the individual's taxable income;

C is the individual's basic minimum tax exemption; and

D is the individual's basic tax credit determined under section 127.531.

Section 127.531 of the Act permits an individual to claim a deduction in computing minimum tax for most non-refundable personal tax credits.

Section 127.531 is amended to clarify, that the amount deductible for minimum tax purposes in respect of a particular tax credit referred to in that section is equal to the amount that would be deductible for regular income tax purposes if minimum tax were not applicable. For example, if the total of an individual's eligible charitable gifts for a year is $10,000 and the individual chooses to claim only $8,000 for Part I tax purposes, in computing the individual's basic credit for minimum tax purposes only $8,000 may be taken into account.

This amendment applies to the 2002 and subsequent taxation years.

Clause 70

Private Corporations – "refundable dividend tax on hand"

ITA
129(3)(*a*)

Section 129 of the Act allows a private corporation that pays a taxable dividend to obtain a partial refund of the income taxes it has paid on its investment income. As part of subsection 129(3)'s definition "refundable dividend tax on hand" (RDTOH) for this purpose, paragraph 129(3)(*a*) adds to the RDTOH of a Canadian-controlled private corporation (CCPC) at the end of a taxation year the least of three amounts.

The first amount, in subparagraph 129(3)(*a*)(i), is 26 2/3% of the CCPC's "aggregate investment income" for the year (defined in subsection 129(4)), less the excess of the CCPC's subsection 126(1) foreign tax credits for the year over 9 1/3% of its "foreign investment income" for the year. This 9 1/3% figure represents the difference between an assumed tax rate of 36% on the CCPC's foreign investment income and the 26 2/3% refundable amount. With recent and planned reductions in corporate tax rates, that assumed rate is no longer appropriate. The reference to 9 1/3% is therefore replaced with a reference to 3 1/3%, which reflects an assumed tax rate of 30%. (The existing 36% assumed rate approximated the total of a 30% basic rate and the 6 2/3% additional tax under section 123.3 of the Act; similarly, the new 30% assumed rate is roughly equal to a 25% basic rate plus the additional tax.)

The second amount, in subparagraph 129(3)(*a*)(ii), is 26 2/3% of a corporation's taxable income, less income that either benefited from the section 125 small business deduction or supported a foreign tax credit (FTC). Income that supported an FTC is measured by multiplying both the corporation's non-business- and its business-income FTCs by factors that reflect assumed Canadian tax rates. Subparagraph 129(3)(*a*)(ii) is amended to adjust these factors. The factor for non-business income FTCs will become 10/3; the factor for business-income FTCs will become 3. These imply assumed tax rates of 30% and 33.3%, respectively.

These amendments apply to the 2003 and subsequent taxation years.

Clause 71

Taxation Year of Mutual Fund Trust

ITA
132.11(1)

Section 132.11 of the Act generally allows a mutual fund trust to elect to have taxation years that end on December 15, rather than on December 31.

Where a trust makes this election, each subsequent taxation year of the trust is deemed to start on December 16 of a calendar year and to end on December 15 of the following calendar year, unless any of certain events intervenes. One of the events that can intervene, and that results in an earlier year-end, is a qualifying exchange under section 132.2 of the Act.

As a consequence of the restructuring of section 132.2, the reference in paragraph 132.11(1)(*b*) to paragraph 132.2(1)(*b*) is replaced by a reference to paragraph 132.2(3)(*b*).

This amendment applies after 1998 except that, in applying the amended version of paragraph 132.11(1)(*b*) to taxation years that end before 2000, the paragraph is to be read as though it did not contain the words "subject to subsection (1.1)".

Paragraph 132.11(1)(*c*) generally provides that each fiscal period of a mutual fund trust that has made an election under subsection 132.11(1) shall end no later than the end of the trust's taxation year that ends on December 15th.

The French-language version of paragraph 132.11(1)(*c*) is amended to clarify that the paragraph applies to each fiscal period of the trust that either begins in a taxation year of the trust that ends on December 15 because of an election under paragraph 132.11(1)(*a*) or that ends in a subsequent taxation year of the trust. This technical change does not represent a change in policy.

This amendment applies to the 1998 and subsequent taxation years.

Clause 72

Mutual Fund Qualifying Exchanges

ITA
132.2

Section 132.2 of the Act provides rules to allow two mutual fund trusts, or a mutual fund trust and a mutual fund corporation, to merge on a tax-deferred basis. Such a merger is referred to as a "qualifying exchange".

In addition to introducing several substantive improvements to the rules in section 132.2, these amendments restructure the provision as a whole. In general terms, the section is now organized as follows: new subsection 132.2(1) sets out definitions that apply for the section; subsection (2) describes the order in which the events that make up a qualifying exchange are considered to have occurred; subsection (3) provides a set of general rules; subsection (4) deals with non-depreciable property that is transferred on the qualifying exchange; and subsection (5) deals with depreciable property that is transferred. Subsection (6) establishes the due date for the election to treat a transfer as a qualifying exchange; and subsection (7) provides authority for the Minister of National Revenue to allow that election to be amended or revoked.

Despite this restructuring, the basic principles of section 132.2 remain unchanged, as do most aspects of its operation. The exceptions – the areas where these amendments change the provision substantively – have to do with depreciable property that is transferred on a qualifying exchange, and with the election to treat a transaction as a qualifying exchange.

Transfers of Depreciable Property

In its current form, section 132.2 does not deal comprehensively with transfers of depreciable property between mutual funds. In particular, the deemed timing of the transfer, in relation to the deemed year-end of the funds, may prevent either fund from claiming capital cost allowance (CCA) for the last taxation year that began before the qualifying exchange. The transferor has disposed of the property two moments before the end of its year, and the transferee will not acquire it until the last moment of its own year.

To ensure that one CCA claim is available for that last year, new subsection 132.2(5) provides a special regime for qualifying exchanges that include transfers of depreciable property. A key aspect of these special rules is the ordering of events in accordance with new subsection 132.2(2). That subsection provides that, starting with the actual (i.e., legal) transfer of property between a transferor fund and a transferee fund that carry out a qualifying exchange, the following series of times occurs, each immediately after the previous one:

Name of Time	Description	Reference
the transfer time	The actual transfer of the property between the funds takes place.	definition "qualifying exchange" in 132.2(1)
the first intervening time	The funds are treated as having disposed of and reacquired non-transferred property (other than depreciable property).	132.2(3)(*a*)
the acquisition time	The transferee is treated as having acquired transferred property (other than depreciable property); the funds' taxation years are treated as ending.	132.2(4)(*a*); 132.2(3)(*b*)
the beginning of the funds' first post-exchange years		132.2(3)(*b*)
the depreciables disposition time	The transferor is deemed to have disposed of any transferred property that is depreciable property.	132.2(5)(*a*)
the second intervening time	The funds are treated as having disposed of and reacquired any non-transferred property that is depreciable property.	132.2(3)(*c*)

the depreciables acquisition time	The transferee is deemed to have acquired any transferred property that is depreciable property.	132.2(5)(*b*)

As a result of this timing, the transferor fund will be treated as owning, until after its first post-exchange year has begun, any depreciable property that is being transferred. This will ensure that the transfer does not prevent the transferor from deducting CCA in respect of property of that class, for its taxation year that ends at the acquisition time. The new rule also ensures that the transferee does not duplicate that deduction, by treating the transferee as having acquired the property only after its new taxation year has begun.

This treatment of depreciable property applies, along with most aspects of the restructuring of section 132.2, to qualifying exchanges that take place after 1998.

Timing of Election

For section 132.2 to apply to a transfer of property between mutual funds, the definition "qualifying exchange" currently requires the funds to file their joint election in prescribed form with the Minister of National Revenue within six months after the transfer time. This timing requirement is changed to allow greater flexibility. The amended definition "qualifying exchange" requires that the funds' election be made before the election's "due date", defined in new subsection 132.2(6) to mean either the day that is six months after the day that includes the transfer time or any later day that the Minister accepts, on joint application by the funds. An example of a case in which the Minister might accept such an application would be one in which the Minister has already decided to accept a late filing of the funds' returns of income for the taxation year that includes the qualifying exchange.

In certain cases, mutual funds that have elected to treat a transfer as a qualifying exchange may wish to amend, or even revoke, their election. New subsection 132.2(7) allows the funds to do this, on joint application and with the permission of the Minister.

New subsections 132.2(6) and (7), and the amended definition "qualifying exchange" in subsection 132.2(1), apply to qualifying exchanges that take place after June 1994.

Clause 73

Non-resident-owned Investment Corporations – Transition

ITA
134.1(2)

Section 134.1 of the Act was enacted, along with section 134.2, in 2001 to provide transitional relief for corporations that cease to be non-resident owned investment corporations (NROs). The essence of the relief provided in section 134.1 is to allow such a corporation to recover refundable tax by paying a dividend in its "first non-NRO year". In its current form, the section applies only in respect of dividends paid to a non-resident person or another NRO. There is, however, another kind of shareholder to whom an NRO may pay a dividend in respect of which it is appropriate to apply the section – a trust for the benefit of non-resident persons or their unborn issue. Since such a trust could, under the rules that have governed NROs themselves, have held the shares and debt of an NRO, a dividend to the trust ought to support a refund of the former NRO's refundable tax. Subsection 134.1(2) is therefore amended to include such dividends within the section's scope. The amendment applies on the same basis as section 134.1: that is, to a corporation that ceases to be an NRO because of a transaction or event that occurs, or a circumstance that arises, in a taxation year of the corporation that ends after February 27, 2000.

Clause 74

Cooperative Corporations

ITA
136

Section 136 of the Act provides rules that apply to cooperative corporations.

Subsection 136(1) provides that a cooperative corporation that would otherwise be a private corporation is treated as a private corporation for the purposes of specified provisions of the Act. The subsection is amended to include among those provisions section 123.4 of the Act, which in effect provides reductions in corporate tax rates. This subsection is amended, for the 2001 and subsequent taxation years, to provide that a cooperative corporation that otherwise qualifies as a Canadian-controlled private corporation (CCPC) may use the special rate reduction provided for CCPCs.

Subsection 136(2) of the Act sets out conditions that a corporation must meet in order to be a cooperative corporation. The condition in current paragraph 136(2)(*c*) has two parts: at least 90% of its members must be individuals, other cooperative corporations, or corporations or partnerships that carry on the business of farming; and at least 90% of its shares, if any, must be held by those persons or partnerships.

The second part of this condition is modified to accommodate cases where the shares of a cooperative are held not only by the members themselves, but also by their registered plans (RRSPs, RRIFs, or RESPs). If shares are held by a trust that is governed by such a plan, provided a member of the cooperative is the plan's subscriber or annuitant, as the case may be, those shares will be counted in the same way as if they were held by a member personally. Amended paragraph 136(2)(*c*) and new paragraph 136(2)(*d*), which give effect to this change, apply to the 1998 and subsequent taxation years.

Clause 75

Credit Unions

ITA
137(6)

“member”

Section 137 of the Act provides rules that apply to credit unions. Among the definitions set out in subsection 137(1) is “member,” meaning essentially a member of record who is entitled to the services of the credit union. This definition is amended, for the 1996 and subsequent taxation years, to treat as a member a registered retirement savings plan, registered retirement income fund, or registered education savings plan, provided that the annuitant or subscriber under the plan is a person who meets the existing definition of “member”.

Credit Union not Private Corporation

ITA
137(7)

Subsection 137(7) of the Act provides that a credit union that would otherwise be a private corporation is treated as a private corporation for the purposes of specified provisions of the Act. The subsection is amended to include among those provisions section 123.4 of the Act, which in effect provides reductions in corporate tax rates. This amendment, which applies to the 2001 and subsequent taxation years, provides that a credit union that otherwise qualifies as a Canadian-controlled private corporation (CCPC) may use the special rate reduction provided for CCPCs.

Clause 76

Deposit Insurance Corporations

ITA
137.1

Section 137.1 of the Act provides rules for the taxation of deposit insurance corporations (DICs), including rules that affect the computation of income. In general terms, the premiums that a member institution pays to a DIC are deductible in computing the member's income and are not included in computing the income of the DIC, while any assistance that the DIC provides to the member or the member's depositors is not deductible for the DIC and is included in computing the member's income.

In certain circumstances, two or more DICs may share responsibilities toward a group of members. In such a case, it may be necessary for one DIC to pay to another an amount in respect of premiums. To ensure the appropriate tax consequences of such a payment, subsections 137.1(2) and (4) are amended. New paragraph 137.1(2)(*b*) excludes from the income of a DIC any amount it receives from another DIC, to the extent the amount can reasonably be considered to have been paid out of premiums or assessments received or receivable by the other DIC from its member institutions. New paragraph 137.1(4)(*d*), on the other hand, precludes the paying DIC from deducting the amount in computing its own income. These amendments apply to the 1998 and subsequent taxation years.

Clause 77

Insurance Corporations

ITA
138

Section 138 of the Act provides detailed rules relating to the taxation of insurance corporations.

Insurer's Income or Loss

ITA
138(2)

Subsection 138(2) of the Act provides rules relating to the calculation of the income of a resident life insurer that carries on an insurance business in Canada and in a country outside Canada in a taxation year.

Paragraph 138(2)(*a*) provides that the resident life insurer's income or loss for a taxation year from an insurance business carried on both inside and outside Canada by the insurer is the insurer's income or loss for the year from carrying on that insurance business in Canada. Resident life insurers are, therefore, not subject to Canadian tax on their foreign insurance business income.

Paragraph 138(2)(*b*) provides that taxable capital gains and allowable capital losses from dispositions of property that are not designated insurance property are not included in computing the resident life insurer's income where the property is used or held in the course of carrying on its insurance business.

The expression "designated insurance property" is defined in subsection 138(12) of the Act and in section 2401 of the Regulations.

Subsection 138(2) of the Act is amended in the following ways.

First, it is amended to ensure that the gross investment revenue from property of a resident life insurer will be included in computing the insurer's income from its insurance business in Canada only where the property is a designated insurance property of the insurer for the year.

Second, it is amended to ensure that taxable capital gains and allowable losses from dispositions of the insurer's property used or held by the insurer in the course of carrying on an insurance business will be included in computing the insurer's income for a taxation year from its insurance business in Canada only where the property disposed of was designated insurance property for the taxation year in which the insurer disposed of the property.

The definition "designated insurance property" in subsection 248(1) of the Act adopts the definition in subsection 138(12).

These amendments to subsection 138(2) apply to taxation years that end after 1999.

Computation of Income of Non-Resident Insurer

ITA
138(11.91)

Subsection 138(11.91) of the Act provides rules for the purpose of computing the income of a non-resident insurer that at any time in a particular taxation year commences to carry on business in Canada or that ceases to be exempt from tax under Part I of the Act.

Paragraph 138(11.91)(*f*) of the English Version of the Act applies where the non-resident insurer's capital cost of a depreciable property exceeds the property's fair market value immediately before the commencement of the particular taxation year. To ensure that on a later disposition of the property the non-resident insurer is subject to recapture of any excess capital cost allowance claimed before the particular taxation year, this paragraph preserves the property's capital cost, and treats the excess as having been allowed as capital cost allowance.

Since it is inappropriate to provide for the recapture of capital cost allowance that was claimed when the business was not carried on in Canada or when the non-resident insurer was exempt from tax under Part I of the Act, paragraph 138(11.91)(*f*) of the English version of the Act is repealed.

Paragraph 138(11.91)(*d*) of the French version of the Act is repealed for the same reason.

This amendment applies to taxation years that end after 1999.

Clause 78

Mark-to-Market Rules

ITA
142.6(1)

Subsection 142.6(1) of the Act contains rules that apply where a taxpayer becomes (or ceases to be) a financial institution. This is most likely to happen where the change of status occurs because the taxpayer becomes (or ceases to be) controlled by a financial institution.

If a taxation year of the taxpayer does not end immediately before the time at which its status as a financial institution changes, subparagraph 142.6(1)(*a*)(i) deems the taxpayer's taxation year that would otherwise have included that time to end immediately before that time. A new taxation year begins at that time, and the taxpayer is permitted to adopt a new fiscal period. One purpose for the deemed year-end is to ensure the proper application, in taxation years in which the taxpayer is a financial institution, of the rules, commonly known as the mark-to-market rules,

- in section 142.3 for specified debt obligations, and

- in section 142.5 for market-to-market properties.

The expressions "financial institution", "specified debt obligation" and "mark-to-market property" are defined in section 142.2 of the Act.

Paragraph 142.6(1)(*b*) applies where a taxpayer becomes a financial institution. This paragraph generally provides for a deemed disposition at fair market value of each property held by the taxpayer that is

- a specified debt obligation (other than a specified debt obligation that is a mark-to-market property to which subparagraph 142.6(1)(*b*)(ii) applies)[3], or

- a mark-to-market property for the particular year[4].

This deemed disposition is intended to ensure that amounts brought, because of the mark-to-market rules in sections 142.3 and 142.5 of the Act, into the taxpayer's income for the subsequent year (i.e., the taxation year that includes the time of the change in status) do not include gains or losses accrued before the beginning of that subsequent year.

Subparagraph 142.6(1)(*b*)(ii) is amended to ensure that this is achieved in connection with mark-to-market properties. Amended subparagraph 142.6(1)(*b*)(ii) results in the taxpayer being deemed to have disposed of, immediately before the end of a particular taxation year and for proceeds equal to its fair market value at the end of that year, property held by it that is a mark-to-market property for the subsequent year but was not a mark-to-market property for the particular year.

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[3] Subparagraph 142.6(1)(*b*)(i)

[4] Subparagraph 142.6(1)(*b*)(ii)

Amended subparagraph 142.6(1)(*b*)(ii) applies to taxation years that end after 1998.

Clause 79

Authorized Foreign Banks – Conversion

ITA
142.7(8)(*d*)

Section 142.7 of the Act provides time-limited rules to facilitate foreign banks' transformation of certain Canadian operations, currently carried out through subsidiaries, into Canadian branches (known as "authorized foreign banks") of the foreign banks themselves.

When an authorized foreign bank assumes certain debt obligations of its Canadian affiliates, subsection 142.7(8) applies to govern the tax consequences of the assumption.

Subparagraph 212(1)(*b*)(vii) of the Act provides an exemption from Part XIII tax in respect of interest payments on certain long- and medium-term corporate debt. The exemption can depend upon, among other things, the time at which a debt is issued. New paragraph 142.7(8)(*d*) is added to treat, for the purpose of subparagraph 212(1)(*b*)(vii), a debt obligation assumed by an authorized foreign bank from its Canadian affiliate as having been issued at the time that the debt was issued by the Canadian affiliate.

This amendment applies after June 27, 1999.

Clause 80

Communal Organizations

ITA
143

Section 143 of the Act sets out rules governing the taxation of communal organizations (referred to in that section as "congregations") that do not allow their members to own property in their own right.

Election in Respect of Gifts

ITA
143(3.1)

Subsection 143(3.1) of the Act allows a communal organization that makes an election under subsection 143(2) of the Act to elect to have its total charitable, Crown, cultural and ecological gifts flowed through to those members (the "participating" members) of the congregation for whom an amount is included in income for the year under subsection 143(2).

Subsection 143(3.1) is amended consequential to the addition of new subsection 248(30) of the Act, in respect of gifts made after Announcement Date, to refer to the "eligible amount" of a gift made because of a person being a participating member in the communal organization.

Clause 81

Registered Retirement Savings Plans

ITA
146

Section 146 of the Act provides rules relating to registered retirement savings plans (RRSPs).

Definitions

ITA
146(1)

"earned income"

Subsection 146(1) of the Act defines "earned income", which is relevant in determining the maximum tax-deductible contributions that a taxpayer may make to RRSPs. The definition includes references to a number of provisions that have previously been repealed or re-numbered. The definition is amended to remove these references and update the numbering, with application from the time the provisions were repealed or re-numbered.

Where Tax Payable

ITA
146(10.1)

Subsection 146(10.1) of the Act provides that income earned by a trust governed by a retirement savings plan from non-qualified investments is taxable under Part I. Subparagraph 146(10.1)(*b*)(ii) provides that income for this purpose includes the full amount of capital gains in excess of capital losses. This subparagraph is reworded for clarity, applicable on Royal Assent.

Clause 82

Home Buyers' Plan

ITA
146.01

Section 146.01 of the Act set out the requirements for the Home Buyers' Plan (HBP), which allows the tax-free withdrawal of RRSP funds for the purchase of a home.

Definitions

ITA
146.01(1)

"quarter"

Subsection 146.01(1) of the Act contains the definition "quarter" for purposes of the rules relating to the HBP. This definition is repealed as a consequence of the repeal of subsection 146.01(8) of the Act, where this definition applied. The repeal of this definition applies for the 2002 and subsequent taxation years.

Filing of Prescribed Form

ITA
146.01(8)

In order for an RRSP withdrawal to qualify as an HBP withdrawal, the taxpayer must make a written request in prescribed form to the RRSP issuer. The prescribed form for this purpose is the T1036. Under subsection 146.01(8) of the Act, an RRSP issuer to whom a T1036 is submitted must file the form with the Minister of National

Revenue no later than 15 days after the quarter in which it was so submitted.

Subsection 146.01(8) is repealed. Rather than reporting HBP withdrawals on a quarterly basis by filing the relevant T1036, RRSP issuers will instead be required to report such withdrawals on an annual basis using the T4RSP. It is proposed that Part II of the Regulations be amended to reflect this new reporting requirement.

The repeal of subsection 146.01(8) applies for the 2002 and subsequent taxation years.

Clause 83

Registered Education Savings Plans – Conditions for Registration

ITA
146.1(2)(*g*.3) and (2.3)

Subsection 146.1(2) of the Act sets out the conditions that must be satisfied in order for an education savings plan to be accepted for registration.

New paragraph 146.1(2)(*g*.3) is introduced to preclude non-residents and individuals who have not yet been assigned a Social Insurance Number (SIN) from becoming a beneficiary under a registered education savings plan (RESP) or from benefiting from RESP contributions.

Specifically, paragraph 146.1(2)(*g*.3) requires that an education savings plan not permit an individual to be designated as a beneficiary under the plan and not allow a contribution for a beneficiary under the plan, unless the individual's SIN has been provided to the promoter of the plan and the individual is resident in Canada.

If an individual is designated as a beneficiary under an RESP in conjunction with the transfer of property into the plan from another RESP under which the individual was a beneficiary immediately before the transfer, the requirement that the individual be resident in Canada in order to be designated as a beneficiary does not apply. However, subject to the exceptions in new subsection 146.1(2.3), the individual's SIN has to be provided to the promoter in order for the individual to be designated as a beneficiary under the transferee RESP. This special rule is intended primarily to accommodate transfers from an RESP to a replacement RESP after the beneficiary has ceased to be resident of Canada. (It should be noted that the transfer itself, as a contribution to an RESP, is not subject to the SIN and residency conditions that apply to ordinary contributions.)

New subsection 146.1(2.3) provides two additional exceptions to the SIN condition that are primarily of relevance to RESPs that were entered before 1999 and RESPs that replace such plans. These exceptions recognize that the Canada Customs and Revenue Agency only began requiring the beneficiary's SIN to be provided on the application for registration for plans entered into after 1998.

The first new exception allows an education savings plan that was entered into before 1999 to not require that an individual's SIN be provided in respect of a contribution to the plan. Such contributions, however, continue to be ineligible for the Canada Education Savings Grant. It should be noted that this exception is only relevant for contributions made for existing beneficiaries under such plans. An individual without a SIN is prevented from being designated as a new beneficiary under such a plan.

Under the second new exception, an education savings plan may permit a non-resident individual who does not have a SIN to be designated as a beneficiary under the plan provided that the designation is being made in conjunction with a transfer of property into the plan from another RESP under which the individual was a beneficiary immediately before the transfer. This exception is intended, in particular, to accommodate the transfer of property from an RESP that was entered into before 1999, under which the beneficiary had always been non-resident or had ceased to be resident of Canada before having been assigned a SIN, to a replacement RESP (and successive transfers).

Paragraph 146.1(2)(*g*.3) and subsection 146.1(2.3) apply after the 90th day after Announcement Date.

Clause 84

Registered Retirement Income Funds

ITA
146.3

Section 146.3 of the Act provides rules relating to registered retirement income funds (RRIFs).

Definitions

ITA
146.3(1)

"annuitant"

Subsection 146.3(1) of the Act contains the definition "annuitant" for purposes of the rules relating to RRIFs. Paragraph (*b*) of the definition allows the spouse or common-law partner of a deceased annuitant to become the successor annuitant under the RRIF, if the deceased annuitant so elected or the legal representative of the deceased annuitant consents. When this paragraph was amended by S.C. 2000, c. 12 (the *Modernization of Benefits and Obligations Act*, formerly Bill C-23), the word "or" in the English version was inadvertently removed. The definition is amended to correct this error, and to improve the readability of this paragraph, with the same application as the initial amendment in Bill C-23.

Acceptance of Fund for Registration

ITA
146.3(2)

Subsection 146.3(2) of the Act outlines the conditions that must be satisfied in order for a retirement income fund to be registered as a RRIF.

Paragraph 146.3(2)(*c*) of the English version refers to a carrier who "is a person referred to as a depository in section 146". This paragraph is amended to replace the word "depository" with the word "depositary", which is the term used in section 146. This amendment applies after 2001.

Paragraph 146.3(2)(*f*) prohibits a RRIF from receiving property, other than property transferred from sources listed in that paragraph. The paragraph is amended so that a RRIF may receive property transferred directly from a deferred profit sharing plan (DPSP) in accordance with subsection 147(19) of the Act. This amendment is consequential on an amendment to subsection 147(19) that permits direct transfers from DPSPs to RRIFs. For more details, see the commentary to that subsection. This amendment applies after the 90th day after Announcement Date.

Tax Payable on Income from Non-qualified Investment

ITA
146.3(9)

Subsection 146.3(9) of the Act provides that, if a trust governed by a RRIF acquires a non-qualified investment, any income earned by the trust from the investment is taxable under Part I.

Subsection 146.3(9) is amended to clarify that income from property that was a qualified investment at the time it was acquired but later became non-qualified is also taxable in respect of the non-qualified period. This amendment, which applies to the 2003 and subsequent taxation years, is consistent with the tax treatment of income earned by RRSP trusts from non-qualified investments under subsection 146(10.1) of the Act.

Subparagraph 146.3(9)(*b*)(ii) is reworded for clarity, applicable on Royal Assent.

Clause 85

Deferred Profit Sharing Plans

ITA
147

Section 147 of the Act provides rules relating to DPSPs.

Acceptance of Plan for Registration

ITA
147(2)(*e*)

Subsection 147(2) of the Act sets out the conditions that a profit sharing plan must satisfy in order to be registered as a DPSP. Paragraph 147(2)(*e*) requires that such a plan include a provision stipulating that no right of an employee who is a beneficiary under the plan is capable of surrender or assignment.

Paragraph 147(2)(*e*) is amended in two ways. First, it is amended to extend the application of the provision to require that the stipulation apply to all persons who have rights under a DPSP, not just employee beneficiaries. Second, it is amended to provide that the stipulation is not required to prohibit:

- an assignment under a court order or written agreement relating to the division of property on the breakdown of a marriage or common-law partnership;
- an assignment by a deceased individual's legal representative on the distribution of the individual's estate; and
- a surrender of benefits to avoid revocation of the plan's registration.

These new provisions are similar to the rule in Regulation 8502(*f*) that applies to registered pension plans (RPPs). The new provisions are, in part, consequential on amendments to subsection 147(19) of the Act that accommodate the division of DPSP assets on the breakdown of a marriage or common-law partnership.

These amendments apply after the 90th day after Announcement Date.

Compensation

ITA
147(5.11)

Subsection 147(5.1) of the Act sets out the employer contribution limits for DPSPs. In general terms, the maximum employer contributions in respect of an individual for a calendar year cannot exceed the lesser of: (i) 18% of the individual's compensation for the year from the employer; and (ii) 1/2 of the year's money purchase limit. For this purpose, "compensation" and "money purchase limit" are generally as defined in subsection 147.1(1). Additional cross-plan limits apply if the individual also participates in an RPP sponsored by the employer or in a DPSP or RPP sponsored by a non-arm's length employer.

If the contribution limits are not respected for a calendar year, the Minister of National Revenue may revoke the registration of the DPSP. In addition, the employer is denied a deduction for all contributions made in the year, except as expressly permitted in writing by the Minister.

Subsection 147(5.11) provides a special relieving rule that applies when an employee who is a beneficiary under a DPSP terminates employment with a participating employer in a calendar year. In this circumstance, for the purposes of determining whether the contribution limits have been satisfied, the employee's compensation can be based on the compensation for the immediately preceding year, if it is more than the compensation for the year of termination.

This rule recognizes that it is common practice for an employer to make contributions to a DPSP only after its fiscal year-end, since this is when profits are determined. This can often result in employer contributions being made based (in whole or in part) on employees' earnings in the previous calendar year, but being included in the employees' contribution limits for the current calendar year. This in turn can give rise to over-contributions when an employee terminates employment later in the year before having earned sufficient compensation to support the contribution. However, subsection 147(5.11) generally ensures that such over-contributions do not result in adverse tax effects by allowing the contribution limits to be based on the employee's compensation from the preceding calendar year.

There are, however, two policy concerns with the approach used in subsection 147(5.11). The first concern is that the provision deals only with over-contributions that involve employees who terminate employment. It does not provide relief for similar over-contributions that arise where an employee takes an unpaid leave of absence before having earned sufficient compensation to support any contributions that the employer had already made on his or her behalf. The second concern is that the provision allows DPSP contributions to be made in situations where there is no supporting employment income.

To address these concerns, subsection 147(5.11) is repealed and is proposed to be replaced by a broader relief mechanism in the Regulations. The new mechanism will provide relief in both of the situations described above by allowing over-contributions to be ignored for purposes of the DPSP contribution limits, provided the excess is refunded from the plan. For more details, see the commentary to amended Regulation 8301(2) in Appendix I.

The repeal of subsection 147(5.11) applies to cessations of employment that occur in 2003 and subsequent calendar years and the proposed new refund mechanism in the Regulations is to apply for 2002 and subsequent calendar years. As a result, for excess contributions relating to cessations of employment that occur in 2002, employers will be entitled to relief either by relying on existing 147(5.11) or by using the refund mechanism.

Transfer to RPP, RRSP, RRIF or DPSP

ITA
147(19)

Subsection 147(19) of the Act provides for the tax-free transfer on behalf of an individual of a lump sum amount from a DPSP to an RPP, an RRSP or another DPSP for the individual's benefit. Currently, direct transfers may be made on behalf of an individual only if the individual is an employee or former employee of an employer who participated in the plan or was a spouse or common-law partner of a deceased employee as at the date of the employee's death.

A number of technical amendments are being made to subsection 147(19) to provide greater consistency with the transfer provisions that apply to RPPs.

Subsection 147(19) is amended so that the direct transfer on the death of an employee may be made on behalf of a former spouse or common-law partner of the deceased employee. It is also amended to allow for direct transfers of DPSP assets to be made on behalf of a spouse or common-law partner, or former spouse or common-law partner, of an employee or former employee, where the transfer relates to a division of property arising on the breakdown of their marriage or common-law partnership.

Finally, subsection 147(19) is amended to allow for direct transfers from DPSPs to RRIFs. This is primarily of relevance where the surviving spouse or common-law partner of a deceased employee is over 69 years of age and, therefore, cannot transfer the DPSP assets to an RRSP. In this regard, the French version of paragraph 147(19)(*d*) is amended in order to add a reference to the word "*fonds*".

These amendments apply to amounts transferred after the 90th day after Announcement Date.

Clause 86

Eligible Funeral Arrangements

ITA
148.1

Section 148.1 of the Act provides for the tax-free build-up of income earned on contributions made under an eligible funeral arrangement (EFA), which is an arrangement that provides for the pre-funding of expenses with respect to funeral and cemetery services.

Contributions made to an EFA are not deductible, and income earned in an EFA accrues tax-free. Distributions from an EFA as payment for the provision of funeral or cemetery services are not taxable. Other distributions from an EFA are generally treated first as a distribution of earnings, which is taxable, then as a return of contributions, which is not taxable.

Definitions

ITA
148.1(1)

"relevant contribution"

A "relevant contribution" to a particular arrangement is the amount of any contribution that is not made by way of a transfer from another eligible funeral arrangement or the amount of any other contribution made directly to another eligible funeral arrangement that can reasonably be considered to have been transferred into the particular arrangement.

Paragraph (*b*) of the French version of the definition "relevant contribution" refers to « *l'arrangement visé à l'alinéa a)* » (the arrangement referred to in paragraph (*a*)). This is a source of confusion as paragraph (*a*) refers to two arrangements: the particular arrangement and an eligible federal arrangement. For clarification purposes, the French version of the definition is reformulated in order to introduce the notion of « *arrangement donné* » (a particular arrangement), making it clear which arrangement is referred to in paragraph (*b*).

This amendment applies on Royal Assent.

Transfer of Funds

ITA
148.1(3) to (5)

General Discussion

Section 148.1 is amended to provide specific rules relating to transfers from one EFA account to another. In general terms, the changes are as follows:

- A new provision (paragraph 148.1(4)(*a*)) deems the transferred amount to be distributed to the individual from whose EFA account the amount is transferred. However, if that individual is deceased, the amount is deemed to be distributed to the individual to whose EFA account the amount is transferred. This ensures that the transfer is included in income (to the extent that it does not exceed the income accumulated in the transferor account).

- A new provision (paragraph 148.1(4)(*b*)) deems the transferred amount to be a contribution made to the recipient EFA account other than by way of transfer. This ensures that the earnings portion of the transferred amount is not taxed again when it is distributed from the recipient EFA account.

- The provision that requires EFA distributions to be included in income (subsection 148.1(3)) is amended to ensure that the determination of the amount that can subsequently be distributed from the transferor EFA account on a tax-free basis is reduced by the portion of the transferred amount that was not included in income (i.e., that portion of the transferred amount that represents a return of contributions).

- A new provision (subsection 148.1(5)) provides that these new rules do not apply if the transferor and the recipient EFA accounts are in respect of the same person, the entire balance in the transferor account is transferred to the recipient account and the transferor EFA account is terminated immediately after the transfer.

These changes are described in more detail below.

Income Inclusion on Return of Funds

ITA
148.1(3)

Subsection 148.1(3) of the Act provides for an income inclusion by a taxpayer in the event that there is a distribution of funds from an individual's EFA account to the taxpayer (otherwise than as a payment for the provision of funeral or cemetery services with respect to the individual). The amount of the income inclusion is the lesser of the distributed amount and a second amount. In general terms, this second amount is determined by the formula:

$$A + B - C$$

where

A is the balance in the EFA account immediately before the distribution,

B is the total of all payments made from the EFA account before the distribution for the provision of funeral or cemetery services, and

C is the total of all "relevant contributions" in respect of the EFA account that were made before the distribution.

For the purpose of the description of C, an amount is defined in subsection 148.1(1) to be a "relevant contribution" in respect of a particular EFA account if

- the amount was contributed to the particular EFA account otherwise than by way of transfer from another EFA account, or

- the amount was contributed to another EFA account (otherwise than by way of transfer) and subsequently transferred (either from the original or a subsequent EFA account) to the particular EFA account.

The effect of subsection 148.1(3) is to include in the income of the taxpayer the lesser of the amount received and an amount which generally represents the income accumulated in the EFA account. If the amount received by the taxpayer is greater than the amount included in the taxpayer's income, the excess generally represents a non-taxable refund of relevant contributions (represented by the variable C in the formula).

The description of C is amended so that its value is reduced, in effect, by any relevant contributions previously transferred from the EFA account to another EFA account. This ensures that the amount of the transferred relevant contribution (which, by virtue of subsection 148.1(3), can be distributed from the recipient EFA account tax-free) cannot also be used to support a subsequent tax-free withdrawal from the transferor EFA account.

The description of C is amended to provide that its value is determined by the formula

$$D - E$$

For this purpose, the value of D is the amount determined under the existing description of C. The value of E is the total of all amounts each of which is

- an amount which was previously transferred from the EFA account and deemed, by new subsection 148.1(4), to be a distribution

minus

- the portion of the deemed distribution that was required, by subsection 148.1(3), to be included in computing a taxpayer's income.

This amendment applies to transfers made after Announcement Date.

Deemed Distribution on Transfer

ITA
148.1(4)

New subsection 148.1(4) of the Act contains rules that apply when an amount is transferred from one EFA account to another EFA account of the same or another person.

Paragraph 148.1(4)(*a*) deems the transfer to be a distribution from the transferor EFA account. If the individual from whose account the amount is transferred is alive at the time of the transfer, that individual is deemed to be the recipient of the distribution. Otherwise, the recipient is deemed to be the individual to whose EFA account the amount is transferred. This deeming provision ensures that subsection 148.1(3) applies to the transfer. Consequently, the transferred amount will be included in computing the income of the deemed recipient, except to the extent that the transferred amount exceeds the income accumulated in the transferor EFA account.

Paragraph 148.1(4)(*b*) of the Act deems the amount transferred to be a contribution made (otherwise than by way of transfer) under the recipient EFA account. This ensures that the income portion of the transferred amount (which is included in income, under subsection 148.1(3), as a distribution from the transferor account) is considered to be a "relevant contribution" in respect of the recipient EFA account (which it would not otherwise be, because of the definition "relevant contribution" in subsection 148.1(1)). This allows it to subsequently be withdrawn from the recipient EFA account on a tax-free basis.

New subsection 148.1(4) applies to transfers made after Announcement Date.

Non-application of Subsection (4)

ITA
148.1(5)

New subsection 148.1(5) of the Act provides that new subsection 148.1(4) does not apply when the entire balance of an individual's EFA account is transferred to another EFA account of the same individual and the transferor EFA account is terminated immediately after the transfer. Consequently, there will be no deemed distribution resulting from such a transfer.

New subsection 148.1(5) applies to transfers made after Announcement Date.

The following examples illustrate the application of the amendments to subsection 148.1.

Example 1

Paul sets up an EFA account for the pre-funding of his funeral expenses. He contributes $10,000 to his account, and earns $7,000 of interest in the account. Paul transfers $3,000 to an EFA account which he establishes for his daughter, Gaby.

The transferred amount is deemed to be a distribution to Paul under new paragraph 148.1(4)(a). Consequently, Paul includes in his income, under subsection 148.1(3), an amount of $3,000, which is the lesser of

- *$3,000, which is the amount distributed, and*
- *$7,000, which is the amount determined by the formula under subsection 148.1(3):*

$$A + B - C \text{ (where } C = D - E)$$
$$= \$17{,}000 + \$0 - (\$10{,}000 - \$0)$$

The transfer is treated, in effect, as a distribution of a portion of the income accumulated in the plan.

Under new paragraph 148.1(4)(b), the transferred amount is also deemed to be a contribution made, other than by way of transfer, to Gaby's EFA account. Thus, the $3,000 is considered to be a relevant contribution in respect of Gaby's EFA account, and can subsequently be withdrawn tax-free.

Example 2

The facts are the same as in Example 1, except that Paul transfers $13,000 to Gaby's EFA.

The transferred amount is deemed to be a distribution to Paul under new paragraph 148.1(4)(a). Consequently, Paul includes in his income, under subsection 148.1(3), an amount of $7,000, which is the lesser of

- *$13,000, which is the amount distributed, and*
- *$7,000, which is the amount determined by the formula under subsection 148.1(3):*

A + B – C (where C = D – E)
= $17,000 + $0 – ($10,000 – $0)

The transfer is treated, in effect, as a distribution of all of the income accumulated in the plan ($7,000), which is taxable, plus a return of a portion of the relevant contributions in respect of the EFA ($6,000), which is not taxable.

Under new paragraph 148.1(4)(b), the transferred amount is also deemed to be a contribution made, other than by way of transfer, to Gaby's EFA account. This has no particular significance with respect to the portion of the transfer that represents relevant contributions in respect of Paul's EFA account, since this amount would be considered to be a relevant contribution to Gaby's EFA account under the existing rules. However, it does have significance with respect to the portion of the transfer that represents income in Paul's EFA account, in that it allows that portion to become a relevant contribution in respect of Gaby's EFA account which can then be withdrawn from Gaby's account tax-free.

Example 3

The facts are the same as in Example 2. After the transfer of $13,000, the balance in Paul's EFA account is $4,000, all of which represents relevant contributions in respect of the account. Over the next few years, the account earns an additional $2,500 of interest. Paul then withdraws the entire balance from the account.

The withdrawal is a distribution under subsection 148.1(3). Consequently, Paul includes $2,500 in his income, which is the lesser of:

- *$6,500, which is the amount of the withdrawal, and*
- *$2,500, which is the amount determined by the formula under subsection 148.1(3):*

A + B – C (where C = D – E)
= $6,500 + 0 - ($10,000 - $6,000)

The value of E ($6,000) is the excess of the amount that was previously transferred and to which subsection 148.1(4) applied ($13,000) over the portion of that amount that was included in income under subsection 148.1(3) ($7,000).

Clause 87

Exemptions

ITA
149

Section 149 of the Act provides that no tax is payable under Part I on certain persons' taxable income for a period in a taxation year during which the person is a person listed in that section.

Votes or De Facto Control

ITA
149(1.3)

Subsection 149(1.3) of the Act provides that, for the purposes of applying paragraph 149(1)(*d*.5) and subsection 149(1.2) to a corporation, 90% of the capital of the corporation is considered to be owned by one or more municipalities only if the municipalities are entitled to at least 90% of the votes associated with the shares of the corporation.

Subsection 149(1.3) is replaced, applicable to taxation years that begin after Announcement Date, to provide that paragraphs 149(1)(*d*) to (*d*.6) do not apply to exempt a person's taxable income for a period in a taxation year in two cases.

First, under new paragraph 149(1.3)(*a*), a corporation is not exempt from tax on its taxable income for period in a taxation year if at any time during the period the corporation has issued shares that are owned by one or more persons (other than by certain tax-exempts) that, in total, give them more that 10% of the votes that could be cast at a meeting of shareholders. For this purpose, shares are not taken into account if they are owned by

- Her Majesty in right of Canada or of a province,
- a municipality in Canada, or
- a commission, an association or a corporation, to which any of paragraphs 149(1)(*d*) to (*d*.6) apply.

Second, under new paragraph 149(1.3)(*b*), a person is not exempt because of any of paragraphs 149(1)(*d*) to (*d*.6) from tax on taxable income for a period in a taxation year if at any time in the period the person is, or would be if the person were a corporation, controlled, directly or indirectly in any manner whatever, by a person (or by a group of persons that includes a person) other than:

- Her Majesty in right of Canada or of a province,
- a municipality in Canada, or
- a commission, an association or a corporation, to which any of paragraphs 149(1)(*d*) to (*d*.6) apply.

For further details about the expression "controlled, directly or indirectly in any manner whatever", reference should be made to subsections 256(5.1) and (6) of the Act. In general, the expression refers to a controller who has any direct or indirect influence that, if exercised, would result in control in fact of the person.

Clause 88

Charities

ITA
149.1

Section 149.1 of the Act provides the rules that must be met for charities to obtain and keep registered status. A registered charity is exempt from tax on its taxable income and can issue receipts which entitle its donors to claim tax relief for their donations.

Definitions

ITA
149.1(1)

Subsection 149.1(1) of the Act contains definitions that are relevant for the purposes of section 149.1.

"charitable organization"

The definition "charitable organization" provides that more than 50% of the directors, trustees, officers or similar officials of a charitable organization must deal with each other and with each of the other directors, trustees, officers or similar officials at arm's length.

For a charity that has applied for registration after February 15, 1984 and which has been designated as a private or public foundation, the definition "charitable organization" also requires that not more than 50% of the charity's capital be contributed by a person or group of persons not dealing with each other at arm's length. This definition is amended to replace the "contribution" test with a "control" test. As a result, a charity will not be disqualified from being treated as a charitable organization solely because a person, or a group of persons not dealing with each other at arm's length, has contributed more than 50% of the charity's capital. However, such a person or group is not permitted to control the charity in any way, nor may the person or the members of the group represent more than 50% of the directors, trustees, officers and similar officials of the charity.

This amendment generally applies after 1999.

"disbursement quota"

The "disbursement quota" for a taxation year of a charitable foundation or organization is defined in subsection 149.1(1) of the Act for the purpose of determining the amount that the charity is required to spend on charitable activities or gifts to other charities. One factor in calculating the disbursement quota is a specified proportion of donations for which tax receipts are issued.

The definition "disbursement quota" is amended consequential to the addition of new subsection 248(30) of the Act, in respect of gifts made after Announcement Date, to provide that the amount of a gift for which a tax receipt is issued refers to the "eligible amount" of the gift. For additional information, see the commentary to new subsection 248(30).

"public foundation"

The definition "public foundation" provides that more than 50% of the directors, trustees, officers or similar officials of a public foundation must deal with each other and with each of the other directors, trustees, officers or similar officials at arm's length.

This definition requires that not more than 50% (75% in some cases) of the foundation's capital can be contributed by a person or group of persons not dealing with each other at arm's length. The "contribution" test in the definition is replaced by a "control" test. As a result, a foundation will not be disqualified from being treated as a public foundation solely because a person, or a group of persons not dealing with each other at arm's length, has contributed more than 50% of the foundation's capital. However, such a person or group is not permitted to control the foundation in any way, nor may the person or the members of the group represent more than 50% of the directors, trustees, officers and similar officials of the foundation.

This amendment generally applies after 1999.

Revocation of Registration

ITA
149.1(2), (3) and (4)

Subsections 149.1(2), (3) and (4) of the Act set out the reasons for which the Minister of National Revenue may revoke the registration of a charitable organization, a public foundation and a private foundation, respectively. These subsections are amended to permit the revocation of the registration of such entities if they make gifts (other than gifts made in the course of their charitable activities) to persons or entities that are not qualified donees. A "qualified donee" is essentially a person or entity to which a tax deductible or tax creditable donation may be made.

These amendments apply on Royal Assent.

Accumulation of Property

ITA
149.1(9)

Subsection 149.1(8) of the Act permits a registered charity, with the approval of the Minister of National Revenue, to accumulate property over a specified period for a particular purpose. The amount of such property accumulated is deemed to have been expended in the taxation year of the charity in which it was accumulated. If in fact the charity defaults on this responsibility by not using the property for the approved purpose within the specified period, subsection 149.1(9) treats that property as income of the charity and the amount of a gift for which it issued a receipt. This affects the calculation of the disbursement quota of the charity, with the result that the amount of the property must be actually disbursed in the year following default.

Subsection 149.1(9) is amended consequential to the addition of new subsection 248(30) of the Act, in respect of gifts made after Announcement Date, to provide that the amount of a gift for which a tax receipt is issued refers to the "eligible amount" of a gift. For additional information, see the commentary to new subsection 248(30).

Information May be Communicated

ITA
149.1(15)(*b*)

Section 241 of the Act prohibits the use or communication by an official of information obtained under the Act unless specifically authorized by one of the exceptions found in that section. Paragraph 149.1(15)(*b*) of the Act, which deals with charities, provides that, notwithstanding section 241, the Minister of National Revenue may publish a listing of all registered or previously registered charities indicating the name, location, registration number and, where the charity is no longer registered, the effective date of the revocation, annulment or termination of the charity's registration. This provision does not currently allow for the release of similar information in respect of registered Canadian amateur athletic associations. Since taxpayers who make donations to such associations obtain the same tax relief that is available in respect of donations to registered charities and, since subsection 149.1(15) is intended to provide transparency for the benefit of potential donors, paragraph 149.1(15)(*b*) is amended, effective after Royal Assent to this measure, to allow for the release of such information in respect of Canadian amateur athletic associations.

Clause 89

Assessment

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer and to determinations and redeterminations of amounts of tax deemed to have been paid by a taxpayer.

Provisions Applicable

ITA
152(1.2)

Subsection 152(1.2) is amended to delete the reference to section 126.1 of the Act, consequential to the repeal of that section. For additional information, see the commentary to section 126.1.

This change applies in respect of forms filed after the 90th day after Announcement Date.

Determination of UI Premium Tax Credit

ITA
152(3.4)

This subsection enables a taxpayer to request the Minister of National Revenue to determine the amount deemed by subsection 126.1(6) or (7) of the Act to be an overpayment on account of the taxpayer's liability under Part I of the Act.

This subsection is repealed consequential to the repeal of section 126.1. For additional information, see the commentary to section 126.1.

This change applies in respect of forms filed after the 90th day after Announcement Date.

Notice of Determination

ITA
152(3.5)

Subsection 152(3.5) of the Act requires the Minister of National Revenue to respond to a request for a determination of the UI premium tax credit. This subsection is repealed consequential to the repeal of section 126.1. For additional information, see the commentary to section 126.1.

This change applies in respect of forms filed after the 90th day after Announcement Date.

Clause 90

Instalments

ITA
157(3)

Section 157 of the Act requires a corporation to pay monthly instalments of its total tax payable under Parts I, I.3, VI, VI.1 and XIII.1 of the Act. Subsection 157(3) allows corporations to reduce each monthly instalment by 1/12 of the amount of certain tax refunds, including the "dividend refund" under section 129 of the Act. For most mutual fund corporations, the dividend refund amount is computed according to rules set out in subsection 131(5) of the Act. Paragraph 157(3)(*c*), which allows a mutual fund corporation to apply its dividend refund to reduce its instalments, therefore refers to subsection 131(5). However, prescribed labour-sponsored venture capital corporations (LSVCCs), which are by definition mutual fund corporations, do not use subsection 131(5) to compute their dividend refunds – instead, they use special rules in subsection 131(11) of the Act. To ensure that subsection 157(3) applies appropriately to LSVCCs, this amendment adds to paragraph 157(3)(*c*) a reference to subsection 131(11). The amendment applies for the 1999 and subsequent taxation years.

Clause 91

Person Acting for Another – Personal Liability

ITA
159(3)

Subsection 159(1) of the Act provides, in part, that a legal representative acting for another person is jointly and severally liable for each amount payable by the other person under the Act, to the extent that the representative has possession and control of the other person's assets. If the representative distributes assets of the other person before obtaining a certificate from the Minister of National Revenue that the other person's tax debts have been paid, the Minister may, under subsection 159(3) of the Act, assess the representative for the amount of the debt.

Subsection 159(3) is amended to clarify that a legal representative so assessed after Announcement Date is subject to interest on the assessment without any limit on the amount of interest for which the representative may be liable.

Clause 92

Tax Liability – Non-arm's Length Transfers of Property

ITA
160

Section 160 contains rules regarding the joint and several liability of a taxpayer for the income tax liability of another person (the "tax debtor") who, when not dealing at arm's length with the taxpayer, transferred property to the taxpayer for consideration less than its fair market value.

ITA
160(1)(*e*)

The amount that a taxpayer is liable to pay in respect of the transfer of property from a non-arm's length tax debtor is determined under subsection 160(1) of the Act. The Minister may assess the taxpayer for such a liability under subsection 160(2) of the Act. Paragraph 160(1)(*e*) is amended, in respect of assessments made after Announcement Date, to clarify that the assessment of the taxpayer is subject to interest, without any limit on the amount of interest for which the taxpayer may be liable.

Joint Liability Where s. 69(11) Applies

ITA
160(1.1)

Subsection 160(1.1) of the Act provides that where subsection 69(11) of the Act applies to deem a disposition of property to have occurred at fair market value, both the person disposing of the property and the person acquiring the property are jointly and severally liable for the payment of each other's liabilities arising under the Act as a result of that disposition. The Minister of National Revenue may assess the person for such a liability under subsection 160(2) of the Act. Subsection 160(1.1) is amended, in respect of assessments made after Announcement Date, to clarify that the assessment of the taxpayer is subject to interest.

Joint Liability – Tax on Split Income

ITA
160(1.2)

Subsection 160(1.2) of the Act, which applies in respect of tax owing on split income, is amended in two respects.

First, paragraphs 160(1.2)(*a*), (*b*) and (*d*) are amended to replace the phrase "goods or services" with the phrase "property or services" as a consequence of the same changes made to paragraphs (*b*) and (*c*) of the definition "split income" in subsection 120.4(1). These amendments apply after Announcement Date.

Second, a "postamble" is added to subsection 160(1.2) to clarify that, in respect of assessments made under subsection 160(2) after Announcement Date, the assessment is subject to interest.

Assessment

ITA
160(2)

Subsection 160(2) of the Act allows the Minister of National Revenue to assess a taxpayer at any time in respect of liabilities arising under section 160, with such assessment having the same effect as if it had been made under section 152 of the Act. Subsection 160(2) is amended, in respect of assessments made after Announcement Date, to clarify that the assessment is subject to interest.

Clause 93

Where Excess Refunded

ITA
160.1(3)

Subsection 160.1(3) of the Act allows the Minister of National Revenue to assess a taxpayer in respect of excess refunds and overpayments for which the taxpayer is jointly and severally liable under subsection 160.1(1), (1.1), (2.1) or (2.2) of the Act. Subsection 160.1(3) is amended, in respect of such assessments made after Announcement Date, to clarify that such an assessment is subject to interest, except that no interest is payable to the extent that the excess refund is attributable to the overpayment of a GST tax credit or a child tax benefit.

Clause 94

Joint and Several Liability – Amounts Received out of or under RRSP

ITA
160.2(1) to (3)

Subsection 160.2(1) of the Act provides that a taxpayer who receives benefits out of another person's registered retirement savings plan is jointly and severally liable for the portion of that other person's tax that is attributable to those benefits. Subsection 160.2(2) of the Act provides a similar result with respect to benefits received out of another person's registered retirement income fund. The Minister may assess the taxpayer for such a liability under subsection 160.2(3) of the Act.

Subsections 160.2(1), (2) and (3) are amended, in respect of assessments made after Announcement Date, to clarify that the assessment is subject to interest, without any limit on the amount of interest for which the taxpayer may be liable.

Clause 95

Liability – Amounts Received out of or under RCA Trust

ITA
160.3(1) and (2)

Subsection 160.3(1) of the Act provides that a person who receives benefits from a retirement compensation arrangement that relate to another taxpayer's employment is jointly and severally liable for the portion of that other taxpayer's tax that is attributable to such benefits. The Minister of National Revenue may assess the person for such a liability under subsection 160.3(2) of the Act. Subsections 160.3(1) and (2) are amended, in respect of assessments made after Announcement Date, to clarify that such an assessment is subject to interest, without any limit on the amount of interest for which the person may be liable.

Clause 96

Liability – Transfers by Insolvent Corporation

ITA
160.4(1) to (3)

Subsection 160.4(1) of the Act applies where a transfer of property has been made by a corporation and, as a consequence of the transfer (or the transfer combined with other transactions), the corporation is precluded under subsection 61.3(3) of the Act from deducting an amount under section 61.3. Where this is the case, the transferee is jointly and severally liable with the transferor under subsection 160.4(1) for the transferor's tax under Part I of the Act for the first taxation year of the transferor that ends after the time of the transfer and for preceding taxation years. The liability of the transferee applies up to the amount, if any, by which the fair market value of the property at the time of the transfer exceeds the fair market value of the consideration given for the property transferred.

In addition, subsection 160.4(2) of the Act provides for joint and several liability of subsequent non-arm's length transferees for the corporation's Part I tax if the original transferee makes a further non-arm's length transfer and one of the reasons that the transfer was made was to prevent the enforcement of section 160.4.

Under subsection 160.4(3) of the Act, the Minister of National Revenue may assess a transferee for a liability arising under subsections 160.4(1) or (2).

Subsections 160.4(1), (2) and (3) are amended, in respect of assessments made after Announcement Date, to clarify that such an assessment is subject to interest, without any limit on the amount of interest for which the transferee may be liable.

Clause 97

Penalties

ITA
162

Section 162 of the Act imposes penalties for infractions such as the failure to file a return for a taxation year.

Failure to Provide Identification Number

ITA
162(6)

Subsection 162(6) of the Act provides a penalty for failure by a person or partnership to provide on request their social insurance number or their business number to any person who is required to make an information return in their regard. The French version of this subsection refers to individuals instead of persons, thereby excluding corporations. The provision is therefore amended to replace the word « *particulier* » by the word « *personne* ».

This amendment applies after June 18, 1998, the date on which the penalty in subsection 162(6) was extended to corporations in respect of business numbers.

Clause 98

False Statements or Omissions – GSTC Payments

ITA
163(2)(*c*.1)

Subsection 163(2) of the Act imposes a penalty where a taxpayer knowingly, or in circumstances amounting to gross negligence, participates in or makes a false statement for the purposes of the Act. The penalty is determined with reference to the understatement of tax or the overstatement of amounts deemed to be paid on account of tax. Paragraph 163(2)(*c*.1) imposes a penalty where the false statement relates to the goods and services tax credit (GSTC).

The GSTC provisions were recently amended (S.C. 2002, chapter 9, formerly Bill C-49) to make the credit more responsive to changes in family circumstances by providing that the eligibility to the credit and the amount paid in each quarter reflect such changes that occurred before the end of the preceding quarter rather than in the preceding taxation year.

Paragraph 163(2)(*c*.1) is amended to reflect the new quarterly calculation of the GSTC. This amendment applies to amounts deemed to be paid during months specified for the 2001 and subsequent taxation years.

Clause 99

Refunds

ITA
164

Section 164 of the Act contains rules relating to refunds of taxes, including provisions dealing with repayments, application to other debts, and interest.

Refund of Instalment – Hardship

ITA
164(1.51) to (1.53)

New subsections 164(1.51) to (1.53) of the Act, which apply on Royal Assent, allow the Minister of National Revenue to refund excessive instalment amounts paid on account of a taxpayer's tax liability. In order for such a refund to be made, four conditions must be met. Three of these are set out in new subsection 164(1.51). First, the taxpayer must have paid one or more instalments of tax under Part I or, where the taxpayer is a corporation, Part I.3, VI, VI.1 or XIII of the Act. Second, it must be reasonable to conclude that the total amount of the instalments the taxpayer has paid exceeds the total amount of taxes payable by the taxpayer under those Parts for the year. Third, the Minister must be satisfied that the payment of the instalments has caused or will cause the taxpayer undue hardship.

The last condition is implied in new subsection 164(1.52) of the Act. The availability of an instalment refund in a particular case is a matter of the Minister's discretion. The final condition is therefore that the Minister agree to make the refund. Similarly, new subsection 164(1.52) makes it clear that the amount of any instalment refund is to be decided by the Minister: the Minister may refund all or any part of an excessive instalment.

New subsection 164(1.53) of the Act provides that, for the purposes of computing interest and penalties, a taxpayer that receives an instalment refund is treated as not having paid the instalment to that extent.

Refund of UI Premium Tax Credit

ITA
164(1.6)

Subsection 164(1.6) of the Act provides rules concerning refunds of the UI premium tax credit. This subsection is repealed consequential to the repeal of section 126.1. For additional information, see the commentary to section 126.1

This change applies in respect of forms filed after the 90th day after Announcement Date.

Interest on Refunds and Repayments

ITA
164(3)

Subsection 164(3) of the Act provides for the payment of interest on tax refunds. Two amendments are made to the subsection. First, the preamble of that subsection is being amended to adapt the wording to the new terminology now used elsewhere the Act. Second, the reference to section 126.1 is deleted consequential on the repeal of that section.

These changes apply in respect of forms filed after 90 days after Announcement Date.

Clause 100

Large Corporations Tax

ITA
Part I.3

Part I.3 of the Act imposes a tax (generally known as the "large corporations tax") on the amount by which a large corporation's taxable capital employed in Canada exceeds a $10 million "capital deduction" (shared among related corporations).

Definitions

ITA
181(1)

"financial institution"

Subsection 181(1) of the Act sets out definitions for the purposes of the Part I.3 tax on large corporations. Among these is the term "financial institution," which is relevant for a number of purposes. Most importantly, corporations that are financial institutions compute their capital for the purposes of Part I.3 differently from other corporations. The status of a particular corporation is also relevant to corporations that invest in the particular corporation or hold its debt, since whether certain of those investments are counted in the investor corporation's "investment allowance" – and thus whether they will reduce their own tax under Part I.3 – depends, in part, on whether the particular corporation is a financial institution.

In addition to listing several types of corporations, the definition "financial institution" provides, in its paragraph (*g*), that the definition applies as well to a prescribed corporation. Currently, such corporations are prescribed under section 8604 of the Regulations. Paragraph (*a*) of that regulation provides that a corporation of which all or substantially all of the assets of which are shares or indebtedness of a financial institution (as defined in subsection 181(1) of the Act) to which the corporation is related, is itself prescribed to be a financial institution; the remaining paragraphs list particular corporations by name.

Paragraph (*g*) of the definition is amended to reflect a fundamental change in the technique by which these corporations will be identified as financial institutions. Rather than listing corporations in a regulation, this new approach is to list them in a schedule to the Act. Amended paragraph (*g*) therefore refers to corporations that are either listed in the schedule, as per new subparagraph (*g*)(i), or that are described in new subparagraph (*g*)(ii), currently paragraph (*a*) of section 8604 of the Regulations.

These changes to paragraph (*g*) of the definition apply after December 22, 1997.

As a consequence to the changes to paragraph (*g*) of the definition, section 8604 of the Regulations is to be repealed and a schedule is added at the end of the Act. Subject to a number of deletions due to name changes and amalgamations, the schedule lists those corporations that are currently prescribed under section 8604 immediately before its repeal. The schedule also lists a number of corporations that are not currently prescribed, but meet the requirements for treatment as financial institutions and have asked to be treated as such.

Transitional rules for paragraph (*g*) of the definition ensure that corporations prescribed before the repeal of Regulation 8604 retain the status that they would have had under paragraph (*g*) had it not been amended to exclude prescribed corporations.

As described above, a number of corporations currently not prescribed are listed in the schedule, effective as of dates that precede Announcement Date. Transitional rules ensure that, for any taxation year that begins before Announcement Date, no corporation that deals at arm's length with any of these corporations will lose an investment allowance as a result the corporation's change in status to a financial institution under paragraph (*g*) of the definition.

Clause 101

Taxable Capital Employed in Canada

ITA
181.2

Section 181.2 of the Act provides rules for determining the capital, taxable capital, taxable capital employed in Canada and investment allowance of corporations (other than financial institutions) resident in Canada for the purposes of the Part I.3 tax on large corporations.

Section 181.2 is amended in two respects. First, subsections 181.2(3) and (5) of the Act are amended to clarify the effect of tiered partnerships: structures in which one partnership is a member of another partnership. Second, an amendment is made to subsection 181.2(3) to accommodate a change to the accounting presentation of redeemable preferred shares.

Tiered Partnerships

Subsection 181.2(3) defines the "capital" of a corporation, and in paragraph 181.2(3)(*g*) includes in a corporation's capital a pro-rata share of the reserves, deferred foreign exchange gains and indebtedness of any partnership of which it is a member. To determine those amounts, the relevant paragraphs of subsection 181.2(3) are applied to the partnership in the same way as they apply to corporations. Paragraph 181.2(3)(*g*) is amended so that it itself applies on this basis. As a result, the proration of the reserve, deferred gain and debt amounts will carry through any number of tiered partnerships.

Subsection 181.2(4) of the Act provides for the "investment allowance" by which, in broad terms, one corporation's investment in another is excluded from the first corporation's taxable capital. Subsection 181.2(5) determines the carrying value of an interest of a corporation in a partnership for this purpose. Subsection 181.2(5) is amended to ensure that the carrying value of an interest of a corporation in a particular partnership, for the purposes of subsection 181.2(4), includes the carrying value of an interest of the particular partnership in another partnership.

These changes to paragraph 181.2(3)(*g*) and subsection 181.2(5) apply after Announcement Date.

Preferred Shares

In general, a corporation's tax payable under Part I.3 of the Act is computed with reference to amounts reflected in the balance sheet of the corporation, as prepared in accordance with generally accepted accounting principles (GAAP).

The Canadian Institute of Chartered Accountants' *Handbook* (the Handbook), which is the principal authority of GAAP in Canada, requires that a liability of a corporation in respect of a redeemable preferred share be reflected on the corporation's balance sheet. The Handbook provides that this liability may be accounted for in one of two ways. Under the first method, the difference between the stated capital of a share and its redemption value is charged to retained earnings, which in some cases may result in the corporation having negative retained earnings or a deficit. Retained earnings are unaffected under the second method, under which a line account is set up reflecting the redemption liability of the preferred shares.

Current paragraph 181.2(3)(*i*) of the Act allows for a reduction of a corporation's capital, to the extent of any deficit deducted in computing the corporation's shareholders' equity. To accommodate the alternative presentation of a provision for the redemption of preferred shares, the paragraph is amended to refer explicitly to the amount of such a provision.

This amendment applies to taxation years that begin after 1995.

Clause 102

Taxable Capital Employed in Canada of Financial Institution

ITA
181.3

Section 181.3 of the Act provides rules for determining the capital, taxable capital, taxable capital employed in Canada and investment allowance of a financial institution (as defined in subsection 181(1)) for the purposes of the Part I.3 tax on large corporations.

Section 181.3 is amended in two respects. First, changes are made to several paragraphs of subsection 181.3(3) to accommodate a change to the accounting presentation of redeemable preferred shares. Second, a new subparagraph and a new clause are added to paragraph 181.3(3)(*c*) to reflect the manner in which property and casualty insurers are required to account for claims reserves.

Preferred Shares

The accounting procedures described in the notes to amended section 181.2 of the Act are relevant to financial institutions as well as to other corporations, and readers may consult those notes for additional background. As in that section, the amendments introduced to section 181.3 include, in the computation of a deficit deducted in computing shareholders' equity, the amount of any provision for the redemption of preferred shares. This inclusion is added to three specific provisions: subparagraph 181.3(3)(*a*)(v) in respect of financial institutions other than insurers and authorized foreign banks; subparagraph 181.3(3)(*b*)(iv) in respect of Canadian-resident life insurance corporations; and subparagraph 181.3(3)(*c*)(v) in respect of other Canadian-resident insurance companies.

These amendments apply to taxation years that begin after 1995.

Claims Reserves

In general, a corporation is required to compute amounts relevant in determining its tax payable under Part I.3 of the Act using generally accepted accounting principles (GAAP).

The Canadian Institute of Chartered Accountants' *Handbook* (the Handbook), which is the principle authority of GAAP in Canada, requires that property and casualty insurers account for claims reserves on a gross basis, rather than net of reinsurance.

Paragraphs 181.3(3)(*c*) and (*d*) of the Act stipulate the amounts to be included in determining the capital of an insurance corporation resident in Canada (other than a life insurance corporation) and an insurance corporation not resident in Canada, respectively. Among other things, claims reserves are required under these paragraphs to be included in computing the capital of such a corporation.

New subparagraph 181.3(3)(*c*)(vii) and clause 181.3(3)(*d*)(iv)(F) allow such corporations to reduce their capital by an amount that is recoverable through reinsurance, to the extent that the amount relates to an amount that was included in capital as a claims reserve. In this way, claims reserves are included on a net of reinsurance basis under paragraphs 181.3(3)(*c*) and (*d*).

New subparagraph 181.3(3)(*c*)(vii) and clause 181.3(3)(*d*)(iv)(F) apply to taxation years that begin after 1995.

Clause 103

Additional Tax on Excessive Elections

ITA
Part III

Under section 83 of the Act, a private corporation can identify a dividend as a "capital dividend," with the result that the dividend is not taxable to the shareholders who receive it. In concept, a capital dividend is a distribution of the non-taxable portion of the corporation's capital gains, which portion is recorded in the corporation's "capital dividend account". A similar mechanism allows mutual fund corporations and mortgage investment corporations to designate a dividend as a "capital gains dividend" – which is taxable to the shareholder, but as a capital gain.

Part III of the Act (sections 184 and 185) applies a special tax to a corporation that designates as a capital dividend or a capital gains dividend an amount that exceeds the amount available to be paid as such a dividend. If the corporation obtains the consent of its shareholders, it can avoid the special tax by treating the excess amount as a separate taxable dividend.

These amendments simplify Part III and update its language, reduce the rate of the special tax, and modify the requirement for shareholder consent to the recharacterization of an excessive dividend. These amendments apply to dividends that are paid by a corporation after its 1999 taxation year, with a special transitional rule for elections, described below in the notes to subsection 184(5) of the Act.

Tax on Excessive Elections

ITA
184(2)

Subsection 184(2) of the Act applies the tax under Part III of the Act to the amount by which a dividend paid by a corporation as a capital dividend or a capital gains dividend exceeds the amount eligible to be so designated. For greater clarity, the subsection is amended to refer to the full amount of the initial dividend as the "original dividend." That term is then used elsewhere in amended Part III.

The rate of tax imposed by subsection 184(2) is also changed, as part of a series of amendments that reflect recent and planned reductions in tax rates. The rate is reduced from 75% of the excess capital gains dividend to 60% of the excess.

Reduction of Excess

ITA
184(2.1)

Subsection 184(2.1) of the Act is a transitional rule that applies to certain dividends that became payable before June 18, 1987. That subsection has lapsed and is repealed.

Election to Treat Excess as Separate Dividend

ITA
184(3)

Subsection 184(3) of the Act allows a corporation that would otherwise be liable to tax under Part III in respect of an excessive capital dividend or capital gains dividend to treat the excess as a separate taxable dividend, and thus to avoid the tax. The subsection is amended to update and clarify its language.

Concurrence with Election

ITA
184(4)

Subsection 184(4) of the Act sets out the requirements for shareholders' consent to the recharacterization, under subsection 184(3), of an excessive capital dividend or capital gains dividend. This subsection is amended to update and clarify its language.

Exception for Non-taxable Shareholders

ITA
184(5)

New subsection 184(5) of the Act provides an exception to the shareholder consent requirements of subsection 184(4). Where a corporation wishes to recharacterize an excessive dividend under subsection 184(3), and the dividend was paid on a class of shares all of the holders of which are persons all of whose taxable income is exempt from tax (for example, registered plans), the corporation need not obtain the shareholders' consent. Instead, the only requirement imposed by new subsection 184(5) is that the corporation's election be made within 30 months after the time that the original (excessive) dividend became payable.

An election under new subsection 184(5) will be deemed to have been made in a timely manner if it is made within 90 days after these amendments receive Royal Assent.

Clause 104

Revocation Tax

ITA
188(1)

Subsection 188(1) of the Act imposes a tax payable by a registered charity in respect of the revocation of the charity's registration. The tax is generally equal to the total of the value of the assets of the charity plus the amount of receipted donations and inter-charity gifts received by the charity after the "valuation day" of the charity's assets, net of certain eligible disbursements.

Subsection 188(1) is amended consequential to the addition of new subsection 248(30) of the Act, in respect of gifts made after Announcement Date, to refer to the "eligible amount" of a gift for which a receipt was issued by the charity. For additional information, see the commentary to new subsection 248(30).

Clause 105

Financial Institutions Capital Tax

ITA
190.13

Section 190.13 of the Act contains the rules for determining the capital of a financial institution for the purpose of Part VI of the Act. Section 190.13 is amended to accommodate a change to the accounting presentation of provisions for the redemption of preferred shares.

Generally accepted accounting principles (GAAP) are relevant to the determination of amounts referred to in section 190.13. The accounting procedures described in the notes to amended section 181.2 of the Act are therefore relevant in the context of Part VI of the Act, and readers may consult those notes for additional background. As in that section, the amendments introduced to section 190.13 include, in the computation of a deficit deducted in computing shareholders' equity, the amount of any provision for the redemption of preferred shares. This inclusion is added to two specific provisions: subparagraph 190.13(*a*)(v), in respect of financial institutions other than life insurers and authorized foreign banks; and subparagraph 190.13(*b*)(iv) in respect of Canadian-resident life insurance corporations.

These amendments apply to taxation years that begin after 1995.

Clause 106

Excluded Dividend – Partner

ITA
191(6)

Section 191 of the Act sets out a number of rules relating to the taxes imposed, under Part VI.1 of the Act, on taxable Canadian corporations that pay dividends of certain kinds. Those taxes are not payable in respect of "excluded dividends," a term defined in subsection 191(1) of the Act. Dividends paid by a corporation to a shareholder that holds a "substantial interest" in the corporation are excluded dividends.

"Substantial interest" is itself defined in subsection 191(2) of the Act. In general, a shareholder has a substantial interest in a corporation if the shareholder is related to the corporation (otherwise than because of a right under paragraph 251(5)(*b*)) or if the shareholder's holdings meet certain thresholds in terms of votes and value.

If a shareholder has a substantial interest in a corporation, and is also a member of a partnership that holds shares of the corporation, it is appropriate that a dividend paid by the corporation to the partnership be an excluded dividend, to the extent of the shareholder's interest in the dividend. To ensure this result, new subsection 191(6) is added to the rules that govern the Part VI taxes. The new subsection provides that a dividend paid to a partnership is, for the purposes of the "excluded dividend" definition, considered to have been paid ratably to each member of the partnership.

Three technical aspects of the new rule bear special mention. First, the apportionment of the dividend among the partners is based upon each partner's share of the partnership's income for its last fiscal period that ended before the corporation paid the dividend. (If the dividend was paid during the partnership's first fiscal period, the apportionment looks to that period.)

Second, to ensure appropriate effects where there is more than one tier of partnerships between the dividend-paying corporation and the person that holds a substantial interest in the corporation, the new provision applies to itself. That is, if a member of a partnership is itself a partnership, the rule will treat the dividend-paying corporation as having paid a proportionate amount as a dividend not only to the second partnership, but also to that second partnership's members.

Third, in apportioning a dividend among members of a partnership, new subsection 191(6) uses the new definition of "specified proportion," which is added to subsection 248(1) of the Act. For further information, see the commentary to that amendment.

New subsection 191(6) applies to dividends paid after Announcement Date.

Clause 107

Tax on Taxable Dividends

ITA
191.1(1)(*a*)

Subsection 191.1(1) of the Act provides for a tax to be paid by a corporation that has paid taxable dividends on taxable preferred shares. In the case of short-term preferred shares, paragraph 191.1(1)(*a*) sets the rate of the tax at 66 2/3% of the dividend. This rate produces an amount of tax equal to the amount of income tax that would have been collected had a corporate shareholder sought the same after-tax return in the form of interest. That result obtains, at the current 66 2/3 percent rate, if interest income is assumed to be taxed at 40%.

As part of a series of amendments reflecting recent and planned reductions in income tax rates, the rate of tax under paragraph 191.1(1)(*a*) is reduced to 50%of the dividend amount. This provides the desired result on the basis of an assumed tax of 33.3% on interest income, as shown below.

	Dividend	*Interest*
Issuer		
To Holder	$66.67	$100.00
191.1(1)(a) tax	33.33	n/a
Total paid	$100.00	$100.00
Shareholder		
Receives	$66.67	$100.00
Part I tax	NIL	33.33
After tax	$66.67	$66.67

This amendment applies to the 2003 and subsequent taxation years.

Clause 108

Labour-Sponsored Venture Capital Corporations

ITA
204.81(1), (1.1) and (1.2)

Section 204.81 of the Act sets out the conditions for the registration of labour-sponsored venture capital corporations (LSVCCs).

Subsection 204.81(1) permits the Minister of National Revenue to register a corporation as an LSVCC under Part X.3 if its articles satisfy specified conditions, and other requirements are met. Subparagraph 204.81(1)(*c*)(v) sets out the requirements of a federally-registered LSVCC's articles regarding the circumstances in which the LSVCC may redeem shares of its capital stock. The current rule generally provides, pursuant to clause 204.81(1)(*c*)(v)(E), a minimum holding period of eight years for corporations that are incorporated after March 5, 1996.

Clause 204.81(1)(*c*)(v)(E) is amended to require that the articles of a federally-registered LSVCC provide that the LSVCC shall not redeem its shares unless the redemption occurs either

- more than eight years after the day on which the share was issued, or

- in February or on March 1st but not more than 31 days before the day that is eight years after the day on which the share was issued.

This amendment applies to corporations after February 6, 2000 regardless of when they were incorporated.

However, federally-registered LSVCCs that were incorporated before March 6, 1996 may contain statements in their articles that provide that the LSVCC shall not redeem certain of its shares unless the redemption occurs more than five years after the day on which such a share was issued. New subsection 204.81(1.1) provides that in applying clause 204.81(1)(*c*)(v)(E), at any time before 2004, in respect of a corporation incorporated before March 6, 1996, the references in that clause to the word "eight" are replaced with references to the word "five" if, at that time, the relevant statements in the corporation's articles refer to the word "five". This is intended to ensure that the extended (February, or March 1st) redemption provisions required of a federally-registered LSVCC's articles apply equally to shares originally subject to a minimum five year holding period and those subject to a minimum eight year holding period.

New subsection 204.81(1.2) is a transitional rule that provides a federally-registered LSVCC, incorporated before February 7, 2000, with a reasonable amount of time to amend its articles as required by clause 204.81(1)(*c*)(v)(E). Subsection 204.81(1.2) provides that, in applying subsection 204.81(1) at any time before 2004 to such an LSVCC, if the LSVCC's articles comply with subclause 204.81(1)(*c*)(v)(E)(I) (as modified by subsection 204.81(1.1)) those articles are deemed to provide the statement required by subclause 204.81(1)(*c*)(v)(E)(II).

New subsections 204.81(1.1) and (1.2) apply after February 6, 2000. These amendments are part of a set of amendments, announced by the Minister of Finance (News Release 2000-009, dated February 7, 2000) concerning the redemption requirements for federally-registered LSVCCs. For information on a related amendment, see the commentary to subsection 211.8(1) of the Act.

Clause 109

Tax in Respect of Certain Property Acquired by Trusts, etc.

ITA
Part XI

Part XI of the Act sets out rules for the 1% per month penalty tax on deferred income plans and funds in respect of their excess foreign property holdings.

Definitions

ITA
206(1)

"cost amount"

"Cost amount" is defined in subsection 206(1) of the Act for the purposes of Part XI. The definition was introduced in 2001 to deal with arrangements that provided for trust income to be "capitalized" without the trust issuing new units. Under the definition, the cost amount otherwise determined of a taxpayer's interest in such a trust reflects the capitalized amounts. The definition is amended to clarify that it applies to trusts under which all beneficiaries are registered plan trusts (e.g., trusts described in paragraph *(e)* of the definition "trust" in subsection 108(1)).

This amendment applies to months that end after Announcement Date.

"foreign property"

Subsection 206(1) of the Act defines the term "foreign property". Paragraph (g) of this definition provides a list of non-resident organizations the indebtedness of which is exempt from being foreign property. One of these organizations is the Asian Development Bank. The official French name of this bank is "*Banque asiatique de développement*", which is not the name that currently appears in the French version of the Act. Clause (g)(i)(D) of the French version of the definition "foreign property" is therefore amended to correct the reference.

This amendment applies on Royal Assent.

"specified proportion"

Subsection 206(1) of the Act includes a definition of a partner's "specified proportion" of a partnership for a fiscal period. To enable the definition to be used for other purposes as well, it is moved to subsection 248(1) of the Act, and is repealed in subsection 206(1), effective after Announcement Date.

Acquisition of Qualifying Security

ITA
206(3.1)

The French version of subsection 206(3.1) of the Act is amended to correct an erroneous reference. The reference to subparagraph 206(2)(*a*)(iii), which does not exist in the French version of the Act, is replaced by a reference to subparagraph 206(2)(*a*)(ii). This amendment applies to months that end after 1997, which corresponds to the application of the last amendment to subsection 206(3.1).

Clause 110

Tax on Designated Income of Certain Trusts

ITA
Part XII.2

Part XII.2 of the Act imposes a special tax on the designated income (as defined in subsection 210.2(2) of the Act) of certain trusts that are resident in Canada with respect to distributions to non-residents and other designated beneficiaries. One of the objectives of Part XII.2 tax is to prevent the minimization of tax on specified Canadian-source income that would otherwise arise where a Canadian trust's income is distributed to a non-resident and is subject only to Part XIII tax. Part XII.2 tax is also meant to discourage transactions between taxable and tax-exempt beneficiaries designed to allow taxable income earned by a trust to be flowed-through to tax-exempt beneficiaries after the acquisition of a trust unit by the tax-exempt beneficiary from the taxable beneficiary.

Designated Beneficiary

ITA
210

Section 210 of the Act defines "designated beneficiary" for the purpose of Part XII.2. Under paragraphs (*a*) and (*b*) of the definition, a designated beneficiary includes, respectively, a non-resident person and a non-resident-owned investment corporation. Under paragraph (*c*) of the definition, a person exempt from tax under Part I of the Act is not a designated beneficiary because of owning an interest in a trust unless, generally speaking, a taxable entity previously owned that interest. Under paragraph (*d*) of the definition, a trust is a designated beneficiary of another trust if a beneficiary of the trust includes, generally, either a person or partnership described in any of paragraphs (*a*), (*b*), (*c*) or (*e*) of the definition or another trust (other than a testamentary trust resident in Canada). Under paragraph (*e*) of the definition, a partnership is a designated beneficiary of a trust if a member of the partnership is a person described in paragraph (*a*), (*b*) or (*d*) of the definition, another partnership or a person exempt from tax under Part I by reason of subsection 149(1) of the Act.

The opening words of the definition "designated beneficiary" are amended so that the references in the definition to a "trust" under which there may be a designated beneficiary are references to a "particular trust".

Paragraph (*c*) of the definition "designated beneficiary" is amended to clarify that a designated beneficiary of a particular trust includes, except as provided in subparagraphs (*c*)(i) and (ii) of the definition, a person who is, because of subsection 149(1), exempt from tax under Part I on all or part of their taxable income and who acquired an interest in the particular trust after October 1, 1987 directly or indirectly from a beneficiary under the particular trust.

Paragraph (*d*) of the definition "designated beneficiary" is amended so that a designated beneficiary of a particular trust does not include another trust having as a beneficiary a trust described in any of subparagraphs (*d*)(i) to (iii) of the definition. The trusts described in those subparagraphs are:

- a mutual fund trust,
- a trust that is exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income and that is, because of the application of subparagraph 210(*c*)(i) or (ii), not a designated beneficiary of the other trust, and

- a trust, none of the beneficiaries of which is a designated beneficiary of it, and whose interest in the other trust was owned, at all times after the day on which the interest was created, either by it (i.e., the specified third trust) or by persons who were exempt because of subsection 149(1) from tax under Part I on all of their taxable income.

Paragraph (*d*) of the definition is also amended to clarify that a designated beneficiary of a particular trust includes another trust (except a testamentary trust, a mutual fund trust or a trust that is exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income) if a beneficiary of the other trust includes a person or partnership that is or would, if the person or partnership were at that time a beneficiary of the particular trust, be a designated beneficiary of the particular trust because of paragraph (*a*), (*b*), (*c*) or (*e*) of the definition. In addition, references in paragraph (*d*) of the definition to the expression "resident in Canada" are removed as these are unnecessary given that paragraph (*a*) of the definition provides that a non-resident person is a designated beneficiary.

Paragraph (*e*) of the definition is amended to clarify that, under subparagraph (*e*)(i), a designated beneficiary of a particular trust includes a particular partnership any of the members of which is another partnership or a person who is or would, if the person were at that time a beneficiary of the particular trust, be a designated beneficiary of the particular trust because of paragraphs (*a*), (*b*) or (*d*) of the definition.

Paragraph (*e*) of the definition is also amended so that a designated beneficiary of a particular trust does not include, if the conditions set out in clauses (*e*)(ii)(A) and (B) are met, a particular partnership a member of which is a person exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income. Where these conditions are not met, the particular partnership will be a designated beneficiary of the particular trust if any of the members of the particular partnership is, at that time, a person exempt because of subsection 149(1) from tax under Part I on all or part of its taxable income. The conditions set out in clauses (*e*)(ii)(A) and (B) (i.e., that must be met in order for the particular partnership not to be a designated beneficiary of the particular trust where subparagraph (*e*)(ii) otherwise applies) are that:

- the interest of the particular partnership in the particular trust was owned, at all times after the day on which the interest was created, by the particular partnership or by persons who were exempt because of subsection 149(1) from tax under Part I on all of their taxable income, and

- none of the members of the particular partnership at that time is a person or partnership described in subparagraph (*e*)(i) of the definition.

These amendments apply to the 1996 and subsequent taxation years.

Clause 111

Application of Part

ITA
210.1

Section 210.1 of the Act provides a list of trusts to which Part XII.2 does not apply.

Section 210.1 is amended, consequential on the amendments to section 210 of the Act (described in the commentary above), to clarify that it applies only to determine to which trusts the special Part XII.2 tax does not apply. Section 210.1 does not apply, for example, to determine whether a trust referred to in that section may have a designated beneficiary.

This amendment applies to the 1996 and subsequent taxation years.

Clause 112

Designated Income

ITA
210.2(2)(*b*)

The tax under Part XII.2 of the Act is calculated by reference to a trust's "designated income" (as determined under subsection 210.2(2)). Designated income is calculated by reference to taxable capital gains and allowable capital losses from dispositions of the trust's taxable Canadian property.

Paragraph 210.2(2)(*b*) of the Act is amended so that a trust's designated income is calculated by reference also to taxable capital gains and allowable capital losses from a disposition by the trust of particular property (other than property described in any of subparagraphs 128.1(4)(*b*)(i) to (iii) of the Act) described in clauses 210.2(2)(*b*)(ii)(A) and (B).

Clause 210.2(2)(*b*)(ii)(A) requires that the particular property disposed of (or property for which the particular property is a substitute) be property (referred to in this commentary as the "transferred property") that was transferred to a particular trust in circumstances in which subsection 73(1) or 107.4(3) of the Act applied. This condition will be met whether the particular trust is the trust in respect of which the designated income is being determined, or any other trust to which the transferred property was transferred in circumstances in which subsection 73(1) or 107.4(3) applied and that subsequently transferred, directly or indirectly, the property to the trust in respect of which the designated income is being determined.

Clause 210.2(2)(*b*)(ii)(B) requires that either

- it be reasonable to conclude that the transferred property was, at a particular time, transferred (as described in clause 210.2(2)(*b*)(ii)(A)) to the particular trust in anticipation of the emigration of a person beneficially interested at the particular time in the particular trust and that a person (whether the anticipated person or another) beneficially interested at that time in the particular trust subsequently ceases to reside in Canada, or

- at the particular time that the transferred property was transferred (as described in clause 210.2(2)(*b*)(ii)(A)) to the particular trust the terms of the particular trust satisfy the conditions in subparagraph 73(1.01)(*c*)(i) or (iii) of the Act and that it be reasonable to conclude that the transfer was made in connection with the cessation of residence, on or before that time, of a person who was, at that time, beneficially interested in the particular trust and a spouse or common-law partner, as the case may be, of the transferor of the transferred property to the particular trust.

This amendment applies to trust dispositions, of property by a trust, that occur after Announcement Date.

Clause 113

Recovery of Labour-Sponsored Funds Tax Credit

ITA
Part XII.5

Part XII.5 of the Act (sections 211.7 to 211.9) provides for a special tax that is designed to recover the federal tax credit under section 127.4 of the Act with respect to the original acquisition of a share issued by a labour-sponsored venture capital corporation (LSVCC).

This tax applies where there is a disposition of an "approved share", as defined in subsection 127.4(1) of the Act.

Disposition of Approved Share

ITA
211.8(1)

Subsection 211.8(1) of the Act provides that the special tax under Part XII.5 generally applies where shares in a federally-registered LSVCC that qualify for the federal LSVCC tax credit are redeemed prior to the expiry of a minimum period. In the case of shares the "original acquisition" (as defined in subsection 127.4(1) of the Act) of which occurred before March 6, 1996, there is no recovery of the tax credit for a share redeemed more than five years after the day on which the share was issued. For shares the original acquisition of which occurs after March 5, 1996, the recovery generally applies where a share is redeemed less than eight years after the day on which it was issued.

Subsection 211.8(1) is amended so that there is no Part XII.5 tax in respect of the redemption by a federally-registered LSVCC of a share the original acquisition of which was after March 5, 1996, if the redemption occurs on a day that is in February or on March 1st of a calendar year and that day is no more than 31 days before the day that is eight years after the day on which the share was issued. For a share the original acquisition of which occurred before March 6, 1996, the circumstances in which there is no recovery of the tax credit are extended to include the redemption of the share on a day that is in February or on March 1st of a calendar year if that day is no more than 31 days before the day that is five years after the day on which the share was issued.

This amendment applies to redemptions, acquisitions, cancellations and dispositions that occur after November 15, 1995.

This amendment is part of a set of amendments, announced by the Minister of Finance (News Release 2000-009, dated February 7, 2000) concerning the redemption requirements for federally-registered LSVCCs. The set of amendments is intended to accommodate taxpayers wishing to acquire new LSVCC shares in the first 60 days of a year using the proceeds from the redemption of LSVCC shares. Other related changes include amendments to section 204.81 of the Act. For additional information, see the commentary on those provisions.

Example 1

On February 2nd, 1998 a federally-registered LSVCC redeemed 200 Class A shares owned by Charles. The original acquisition by Charles of the shares was on March 1, 1993, the same day on which the shares were issued. The issuing LSVCC was incorporated on December 1, 1992. The LSVCC's Articles comply with the applicable registration requirements.

Results:

1. Under new clause (i)(C) of the description of B in paragraph 211.8(1)(a), there will be no recovery of the tax credit on the redemption of the 200 shares because the original acquisition of the shares was before March 6, 1996 and the redemption occurred on a day in February not more than 31 days before the day that is five years after the day on which the shares were issued.

2. Because of new subsection 204.81(1.2), subsection 204.81(6) of the Act would not apply to allow the Minister of National Revenue to revoke the LSVCC's registration solely because of the redemption.

Example 2

On February 15, 2005 a federally-registered LSVCC redeemed 200 Class A shares owned by Marguerite. The circumstances of the redemption are not described in any of the provisions, described in clauses 204.81(1)(c)(v)(A) to (D) of the Act, of the LSVCC's articles. The original acquisition by Marguerite of the first 100 shares was on March 1, 1997, although the shares were issued on March 12th, 1997. The original acquisition by Marguerite of the second 100 shares was on February 29, 2000, the same day on which the shares were issued. The LSVCC was incorporated on May 1, 1996.

Results:

1. Under new subparagraph (i.1) of the description of B in paragraph 211.8(1)(a), there will be no recovery of the tax credit on the redemption of the first 100 shares because the redemption occurred in February on a day not more than 31 days before the day that is eight years after the day on which the shares were issued. Subparagraph (i) of the description of variable B in paragraph 211.8(1)(a) does not apply because the original acquisition of the shares was not before March 6, 1996.

2. Under new subparagraph (i.1) of the description of B in paragraph 211.8(1)(a), there will be a recovery of the tax credit on the redemption of the second 100 shares because the redemption occurred less than eight years after the day on which the share was issued and more than 31 days before the day that is eight years after the day on which the shares were issued.

3. Because of new subsection 204.81(1.2), subsection 204.81(6) would not apply to allow the Minister of National Revenue to revoke the LSVCC's registration solely because of the redemption of the first 100 shares. However, the early redemption by the corporation of the second 100 shares, in violation of the provisions of its articles described in clause 204.81(1)(c)(v)(E), authorizes the Minister of National Revenue to revoke the LSVCC's registration under subsection 204.81(6).

Clause 114

Taxation of Non-Residents

ITA
Part XIII

Part XIII of the Act applies a tax on certain amounts paid by a person resident in Canada to a non-resident person.

Non-Resident Withholding Tax – Interest

ITA
212(1)(*b*)(iv)

Paragraph 212(1)(*b*) of the Act both applies tax under Part XIII of the Act to interest paid or credited by a person resident in Canada to a non-resident person and includes a number of exemptions from the tax. One of these, in subparagraph 212(1)(*b*)(iv), is for interest payable to an arm's length person who holds a valid "certificate of exemption". These certificates, issued by the Minister of National Revenue under the authority provided by subsection 212(14) of the Act, are generally available to foreign pension entities, charities and certain other tax-exempt entities.

In its current form, subparagraph 212(1)(*b*)(iv) applies only to interest on a "bond, debenture or similar obligation." Since this restriction may unduly limit the scope of the provision, it is broadened to encompass all forms of indebtedness. It should be noted, however, that no change is made to the requirement that the Canadian-resident payer of the interest and the non-resident recipient deal at arm's length.

This amendment applies to the 1998 and subsequent taxation years.

ITA
212(1)(*b*)(xii)

Subparagraph 212(1)(*b*)(xii) provides an exemption for interest payable under certain securities lending arrangements by registered or licensed securities dealers resident in Canada. Given the current definition of "securities lending arrangement" in subsection 260(1) of the Act, this exemption is only available to dealers who are dealing at arm's length with the other parties to the arrangements.

Consequential to the amendments to the definition of "securities lending arrangement" in subsection 260(1), which now includes certain arrangements between non-arm's length parties, the amendment to subparagraph 212(1)(*b*)(xii) confirms that the exemption is limited to arm's length arrangements.

This amendment applies to arrangements made after 2002.

ITA
212(1)(*b*)(xiii)

Securities lending arrangements often include an obligation for one party to compensate the other for certain income amounts. In the absence of special rules, these compensation payments may be subject to tax under Part XIII if they are paid by a person resident in Canada to a non-resident person.

New subparagraph 212(1)(*b*)(xiii) exempts from tax under Part XIII certain interest compensation payments made to a non-resident by a borrower resident in Canada under a securities lending arrangement. For this exemption to apply,

- the payments must be made by the borrower in the course of carrying on its business outside of Canada; and

- the securities lent must be issued by a non-resident issuer.

This amendment applies to securities lending arrangements entered into after May 1995.

Rents, Royalties, etc.

ITA
212(1)(*d*)(xii)

Paragraph 212(1)(*d*) of the Act describes various amounts, in the nature of rent, royalties and similar payments, on which tax under Part XIII of the Act is imposed. Subparagraphs 212(1)(*d*)(vi) through (xi) list payments to which the tax does not apply. A new exclusion is added in new subparagraph 212(1)(*d*)(xii), for the 2000 and subsequent taxation years. The new subparagraph clarifies that subsection 212(5) of the Act, which is amended as described below, is the sole provision in Part XIII that applies the tax to payments for rights in or to use a film or video that is used or reproduced in Canada.

Exempt Dividends

ITA
212(2.1)

New subsection 212(2.1) is added to exempt from Part XIII tax certain dividend compensation payments made to a non-resident by a Canadian securities borrower under a securities lending arrangement if

- the payments were deemed to be dividends by subparagraph 260(8)(*a*)(i) of the Act;
- the payments were made by the borrower in the course of carrying on its business outside of Canada; and
- the securities lent were issued by a non-resident issuer.

This subsection applies to securities lending arrangements entered into after May 1995.

Replacement Obligations

ITA
212(3)

Among the exceptions to the imposition of tax under Part XIII of the Act on interest is one found in subparagraph 212(1)(*b*)(vii) for interest paid by a corporation resident in Canada on its medium- and long-term arm's length debt. Subsection 212(3), which applies for the purpose of subparagraph 212(1)(*b*)(vii), allows a corporation in certain circumstances of financial difficulty to treat a debt obligation that replaces another as having been issued when that other obligation was issued. The circumstances in which this is possible are set out in paragraphs 212(3)(*a*) to (*c*). Paragraph 212(3)(*b*) requires that, for the subsection to apply, it must be possible to regard the proceeds of the replacement borrowing as being used in financing an active business that was carried on in Canada, by the issuing company or one with which it does not deal at arm's length, immediately before the replacement obligation was issued.

There is no clear basis in tax policy for this requirement. The condition in paragraph 212(3)(*b*) is repealed for replacement debt obligations that are issued after June 10, 2001.

Motion Picture Films

ITA
212(5)

Subsection 212(5) of the Act applies tax under Part XIII to, in general terms, any amount that a person resident in Canada pays to a non-resident person for a right in or to the use of a motion picture film or video product that has been or is to be used or reproduced in Canada (otherwise than for a news program). As presently worded, the subsection can be read as applying even if the payment in question is not for that Canadian use or reproduction, but relates instead to employment of the film or video in some other country. Accordingly, subsection 212(5) is amended to impose tax only to the extent that the amount of the payment relates to the use or reproduction of the product in Canada. This amendment applies to the 2000 and subsequent taxation years.

Exemptions

ITA
212(9)

Subsection 212(9) of the Act provides an exemption from withholding tax under Part XIII of the Act with respect to certain amounts of a trust's income that are paid or credited to a non-resident beneficiary under the trust and that would otherwise be subject to withholding tax under paragraph 212(1)(*c*). The exemption currently applies only in respect of amounts that are attributable to income of the trust in the form of: dividends or interest received by the trust from a non-resident-owned investment corporation; certain artistic royalties; and interest, where the trust is a mutual fund maintained primarily for the benefit of non-resident persons. If no Part XIII tax would have been payable with respect to the dividends, interest or royalties if they had been paid directly to the beneficiary, no Part

XIII tax is payable with respect to a distribution from trust income to non-resident beneficiaries that derives from the dividends, interest or royalties.

Subsection 212(9) is amended to add a fourth type of trust income to this list of exemptions. In certain circumstances, Canada's Superintendent of Financial Institutions may require a non-resident reinsurer that reinsures Canadian risks to place assets in a trust in Canada. Such a "reinsurance trust" may earn dividend or interest income, which is payable to the non-resident. In recognition of the regulatory requirement for these trusts, subsection 212(9) is amended to provide that, if the dividends or interest would not have borne Canadian tax if the non-resident had earned them directly, they may be distributed to the non-resident free of Part XIII tax.

This amendment applies to amounts paid or credited to non-residents after 2000.

Application of Part XIII Tax Where Non-Resident Operates in Canada

ITA
212(13.2)

Subsection 212(13.2) of the Act is one of several provisions that extend Part XIII tax to apply in particular circumstances – in this case, for the most part, the payment by a non-resident of royalties and similar amounts in respect of a Canadian income source. The principle that underlies subsection 212(13.2) is that if a non-resident has Canadian-source business or resource income, and can deduct in computing that income (strictly speaking, in computing "taxable income earned in Canada") a payment to another non-resident, that payment ought to be treated for purposes of Part XIII tax as though it had been made by a person resident in Canada. This is accomplished by treating the first non-resident – the one making the payment – as a person resident in Canada for those purposes.

In its current form, subsection 212(13.2) applies only if the non-resident making the payment carries on business principally in Canada, manufactures or processes goods in Canada or carries out any of various resource activities here. On the other hand, the rule does not explicitly link that business or activity to the deductibility of the payment: it can be read as applying whether or not the payment is made in relation to the particular business or activity.

Accordingly, subsection 212(13.2) is amended to apply in respect of any portion of a payment (other than one to which the generally comparable rule in subsection 212(13) applies) made by one non-resident person to another that is deductible in computing the first non-resident's taxable income earned in Canada from any source. The only exceptions are payments that are deductible in respect of treaty-protected businesses or treaty-protected properties (as defined in subsection 248(1) of the Act.

This amendment applies to amounts paid or credited after Announcement Date.

Tax on Registered Securities Dealers

ITA
212(19)

Subsection 212(19) of the Act imposes a tax on Canadian-resident registered securities dealers that enter into certain securities lending arrangements described in subparagraph 212(1)(*b*)(xii) of the Act. The tax is calculated, by formula, based in part on the capital or the margin requirement of the relevant provincial laws governing the registration or license of securities dealers.

An earlier amendment to subsection 212(19) removed a reference to the provincial laws under which the taxpayer is registered or licensed. The subsection is further amended, as a consequence of that earlier change, to replace the words "those laws" in subparagraph (*b*)(i) of the description of B in the formula (which no longer have any clear antecedent), with a specific reference to the provincial legislation that govern the registration or license of securities dealers.

This amendment applies to securities lending arrangements entered into after May 28, 1993.

Clause 115

Alternative re Rents and Timber Royalties

ITA
216

Section 216 of the Act allows a non-resident person to file a return of income under Part I in respect of rent on real property in Canada or timber royalties and to pay, instead of the non-resident withholding tax under Part XIII, tax under Part I on the basis of the non-resident's income from the rent or royalties.

Subsection 216(1), which provides the basic rule permitting a non-resident to be taxed under Part I of the Act on this income, is amended to improve its structure and language. Most of the changes are stylistic; the amendment also updates the subsection's reference to the form of the non-resident's Part I tax return, to reflect the implementation of a special return for these non-residents. This amendment applies to taxation years that end after Announcement Date.

In general terms, subsection 216(5) of the Act requires that a person who has previously made an election under subsection 216(1), and who has claimed capital cost allowance in computing income under the subsection, must file a return of income for the year in which the property that was the subject of the election is disposed of. Subsection 216(5) is modified in the same manner as subsection 216(1), again with the main change being an updated description of the relevant form. This amendment applies to taxation years that end after Announcement Date.

Subsection 216(7) of the Act provides that the rules in section 61 of the Act, dealing with income averaging annuity contracts, do not apply in computing a non-resident person's income for a taxation year in respect of which subsection 216(5) applies to the person. Since section 61 is no longer relevant to any current transaction, subsection 216(7) is repealed. This repeal takes effect on Royal assent.

Clause 116

Records and Books

ITA
230(2)

Subsection 230(2) of the Act requires that registered charities and registered Canadian amateur athletic associations keep books and records containing information that will enable the Minister of National Revenue to determine whether there are grounds for the revocation of their registration.

The French version of this subsection is amended to replace the expression « *motifs d'annulation* » by the expression « *motifs de révocation* » in order to be consistent with the terminology used in sections 149.1 and 168 of the Act, which authorize the Minister to revoke the registration of these charities and associations.

This amendment applies on Royal Assent.

ITA
230(3)

Subsection 230(3) provides that where a person has failed to keep adequate records and books of account, the Minister of National Revenue may require them to keep such records and books as the Minister specifies. The French version of this subsection is amended to correct grammatical errors.

This amendment applies on Royal Assent.

Clause 117

Provision of Information

ITA
241

Section 241 of the Act prohibits the use or communication by an official of taxpayer information obtained under the Act unless specifically authorized by one of the exceptions found in that section.

Disclosure of Taxpayer Information

ITA
241(4)

Subsection 241(4) of the Act authorizes the limited communication of information to government officials outside of the Canada Customs and Revenue Agency.

New subparagraph 241(4)(*d*)(xv) allows information in respect of film or video productions to be communicated to officials of an office or agency of the government of Canada or of a province that provides a program of assistance for such productions. The information may be communicated only for the purpose of administration or enforcement under the program. New subparagraph 241(4)(*d*)(xvi) extends this authority to communicate information to an official of the Canadian Radio-television and Telecommunications Commission, solely for the purpose of the administration or enforcement of a regulatory function of that Commission.

New subparagraphs 241(4)(*d*)(xv) and (xvi) apply on Royal Assent.

ITA
241(9)

New subsection 241(9) of the Act, which applies on Royal Assent, is added to provide authority to the Minister of Canadian Heritage to publish certain information relevant to the Canadian film or video production tax credit program. The information includes the title of a film or video production in respect of which a certificate has been issued or revoked by that Minister, as well as the names of producers and artists in respect of which that Minister has allotted "points" in determining whether the production is a "Canadian film or video production" under proposed section 1106 of the Regulations.

Clause 118

Interpretation

ITA
248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Definitions

ITA
248(1)

"common-law partner"

An individual becomes the common-law partner of another individual once they have cohabited in a conjugal relationship for at least one year. Paragraph (*a*) of the definition "common-law partner" in subsection 248(1) is amended, effective for the 2001 and subsequent taxation years, to clarify that, for an individual to be considered the common-law partner of another person at a particular time, the individual and that other person need to have cohabited in a conjugal relationship throughout the twelve-month period that ends at that particular time.

"disposition"

The expression "disposition" is used throughout the Act, particularly in provisions relating to transactions involving property.

The definition "disposition" was added to subsection 248(1) by S.C. 2001, chapter 17, ss. 188(5) [formerly Bill C-22]. In general, that definition is applicable to transactions and events that occur after December 23, 1998. The former definition "disposition" was contained in section 54 of the Act, applicable to transactions and events that occurred before December 24, 1998.

Under the definition "disposition" in subsection 248(1), a "disposition" of any property includes the transactions or events described in paragraphs (*a*) to (*d*) of that definition but does not include the transactions or events described in paragraphs (*e*) to (*m*) of that definition.

Under subparagraph (*b*)(i) of that definition, a disposition of a property includes any transaction or event by which, where the property is a share, bond, debenture, note, certificate, mortgage, agreement of sale or similar property, or an interest in it, the property "is redeemed in whole or in part or is cancelled".

The definition "disposition" in subsection 248(1) is amended in the following ways.

First, subparagraph (*b*)(i) of the definition now provides that a disposition of property includes any transaction or event by which, where the property is a share, bond, debenture, note, certificate, mortgage, agreement of sale or similar property, or an interest in it, the property "is in whole or in part redeemed, acquired or cancelled". This amendment makes it clear that a disposition will also include a transaction or event by which the property is acquired.

Second, paragraph (*n*) is added to the definition. New paragraph (*n*) provides that a redemption, an acquisition or a cancellation of a share, or of a right to be issued a share, (which share or which right, as the case may be, is referred to as the "security") of the capital stock of a corporation (the "issuing corporation") held by another corporation (the "disposing corporation") is considered not to be a "disposition" in the case where

- the redemption, acquisition or cancellation occurs as part of a merger or combination of two or more corporations (including the issuing corporation and the disposing corporation) to form one corporate entity (referred to as the "new corporation"),

- the merger or combination is

    - an amalgamation (within the meaning assigned by subsection 87(1) of the Act) to which subsection 87(11) of the Act does not apply, or

  - a foreign merger (within the meaning assigned by subsection 87(8.1) of the Act), and

- either

  - the disposing corporation receives no consideration for the security, or

  - in the case of a foreign merger (within the meaning assigned by subsection 87(8.1)), the disposing corporation receives no consideration for the security other than property that was, immediately before the foreign merger, owned by the issuing corporation and that, on the foreign merger, becomes property of the new corporation .

These amendments apply to redemptions, acquisitions and cancellations that occur after December 23, 1998, and, where the redemption, acquisition or cancellation takes place before [Announcement Date + 1], the Minister of National Revenue shall, notwithstanding subsections 152(4) to (5) of the Act, make any assessment of a taxpayer's tax, interest and penalties payable under that Act for any taxation years that include the time at which such a redemption, acquisition or cancellation occurred that is necessary to take into account the application of the amendments.

In connection with redemptions, acquisitions and cancellations that occur before December 24, 1998, see the commentary to new subsection 248(1.1).

"dividend rental arrangement"

A "dividend rental arrangement" is, in general terms, an arrangement under which one person receives a dividend on a share that has been borrowed from another person who retains the risk of loss or opportunity for gain from fluctuations in the share value. To clarify its application where a partnership is a party to the arrangement, the definition is restructured and amended; its language is also updated in certain respects.

Under the amended definition, the "person" who is the subject of the arrangement – that is, the person who enters into the arrangement in order to receive a dividend – may be a partnership or a person as otherwise defined.

Existing paragraph (*c*) of the definition ensures that the definition includes an arrangement under which a corporation receives a taxable dividend that would be deductible but for subsection 112(2.3) of the

Act, and is obligated to make any of certain kinds of dividend compensation payments. This paragraph is replaced by new paragraph (*b*), which adds to the arrangements described one in which it is not the corporation receiving the dividend that is obligated to make the compensation payment, but rather a partnership of which the corporation is a member.

At first reading, new paragraph (*b*) may seem asymmetrical, in that it expressly covers the case where a partnership is obligated to make the compensation payment, but not the case where a partnership receives the taxable dividend. In fact, the paragraph covers both: since in the latter case the corporate partner is itself already considered to receive the dividend, it is not necessary to add a reference to the partnership in that regard.

The amended definition applies to arrangements made after Announcement Date; it also applies to an arrangement made after November 2, 1998 and before the day after Announcement Date, if the parties jointly elect in writing filed with the Minister of National Revenue within 90 days after Royal assent to these amendments.

“foreign resource property”

The definition “foreign resource property” in subsection 248(1) of the Act is structured to parallel the definition “Canadian resource property” in subsection 66(15) of the Act, with the necessary modifications to reflect the location of the property outside Canada. This definition is amended, effective for property acquired after Announcement Date, as a consequence of changes to the definition “Canadian resource property”.

“former business property”

The definition “former business property” in subsection 248(1) of the Act describes properties the voluntarily disposition of which by a taxpayer are eligible for elections under subsections 13(4) and 44(1) of the Act to defer the recapture of depreciation and capital gains. Subject to certain exceptions, a former business property is generally real property or an interest in real property used primarily in a business. The definition is amended, applicable after Announcement Date, to include a franchise, concession or license for a limited period that is wholly attributable to the carrying on of a business in a fixed place and that is the subject of a valid election under new subsection 13(4.2) of the Act. For further information, refer to the commentary to new subsections 13(4.2) and (4.3).

"qualifying member"

The definition "qualifying member" is added to subsection 248(1).

Under this definition a qualifying member, in respect of a partnership at any time, means a person that is at that time a qualifying member of the partnership for the purposes of subdivision i of Division B of Part I of the Act because of paragraph 95(2)(*o*) of the Act. For more detail, see the commentary to new paragraphs 95(2)(*o*) and (*q*).

This definition is also relevant for the purposes of the amendments to the definitions "exempt earnings" and "exempt loss" in subsection 5907(1) of the Regulations. For more detail, see the commentary to that subsection.

The addition of the definition "qualifying member" applies to taxation years, of a foreign affiliate of a taxpayer, that end after 1999.

"scientific research and experimental development"

Paragraph (*d*) of the definition "scientific research and experimental development" in subsection 248(1) of the Act includes, for the purposes of applying that definition in respect of a taxpayer, certain work (listed therein) undertaken by or on behalf of a taxpayer if the work is commensurate with the needs, and directly in support, of work described in paragraphs (*a*) to (*c*) of that definition that is undertaken by or on behalf of the taxpayer. "Engineering" work is among the work listed in paragraph (*d*). The French version of paragraph (*d*) of the definition is changed, effective upon Royal Assent, to refer to *"travaux de genie"* instead of *"travaux techniques"*.

"specified proportion"

The definition "specified proportion" of a member of a partnership for a fiscal period of the partnership is currently found in subsection 206(1) of the Act. The apportionment that results from the definition is, however, useful for many purposes of the Act, and a number of other provisions apply the same concept. For simplicity, the definition is moved to subsection 248(1) of the Act. As a result, for all purposes of the Act a partner's specified proportion for the period is that proportion of the partnership's total income or loss for that period that is the member's share. If the partnership's income or loss for the period is nil, the proportion is computed as if the partnership had $1 million of income for the period.

This amendment applies after Announcement Date.

Non-Disposition Before December 24, 1998

ITA
248(1.1)

The definition "disposition" was added to subsection 248(1) of the Act by S.C. 2001, chapter 17, subsection 188(5) [formerly Bill C-22]. In general, that definition applies to transactions and events that occur after December 23, 1998. The former definition "disposition" was contained in section 54 of the Act, applicable to transactions and events that occurred before December 24, 1998.

New paragraph (*n*) is added to the definition "disposition" in subsection 248(1) of the Act, applicable to redemptions, acquisitions and cancellations of certain securities that occur after December 23, 1998. For more detail, see the commentary to subsection 248(1).

New subsection 248(1.1) of the Act is added to deal, in a corresponding fashion, with such redemptions, acquisitions and cancellations that occurred before December 24, 1998.

New subsection 248(1.1) provides that a redemption, an acquisition or a cancellation, at any particular time after 1971 and before December 24, 1998, of a share, or of a right to be issued a share, (which share or which right, as the case may be, is referred to as the "security") of the capital stock of a corporation (referred to as the "issuing corporation") held by another corporation (referred to as the "disposing corporation") is not a disposition of the security within the meaning of the definition "disposition" in section 54 (as that section read in its application to transactions and events that occur at the particular time), if

- the redemption, acquisition or cancellation occurred as part of a merger or combination of two or more corporations (including the issuing corporation and the disposing corporation) to form one corporate entity (referred to as the "new corporation"),
- the merger or combination is
    - an amalgamation (within the meaning assigned by subsection 87(1) of the Act as it read at the particular time) to which subsection 87(11) of the Act if in force, and as it read, at the particular time did not apply, or
    - a foreign merger (within the meaning assigned by subsection 87(8.1) of the Act as it read at the particular time), and
- either

- the disposing corporation received no consideration for the security, or

- in the case of a foreign merger (within the meaning assigned by subsection 87(8.1) as it read at the particular time), the disposing corporation received no consideration for the security other than property that was, immediately before the foreign merger, owned by the issuing corporation and that, on the foreign merger, became property of the new corporation.

New subsection 248(1.1) applies on Royal Assent and, notwithstanding subsections 152(4) to (5) of the Act, the Minister of National Revenue may make any assessment of a taxpayer's tax, interest and penalties payable under the Act for a taxation year that includes the time at which a redemption, acquisition or cancellation occurred that is necessary to take into account the application of new subsection 248(1.1) in respect of the redemption, acquisition or cancellation.

Goods and Services Tax – Input Tax Credit and Rebate

ITA
248(16)

Subsection 248(16) of the Act provides rules under which amounts received by, or credited to, a taxpayer as an input tax credit or rebate with respect to the goods and services tax (GST) are deemed to be assistance from a government received by a taxpayer. As a consequence, such amounts are either included in income or reduce the cost or capital cost of the related property, or the amount of the related expenditure or expenditure pool, for tax purposes.

Subsection 248(16) also specifies the time at which the receipt (or credit) of an input tax credit or rebate is deemed to be received as assistance. With respect to input tax credits, subparagraph 248(16)(*a*)(i) provides that the assistance (i.e., the input tax credit) is considered to be received by a taxpayer at the time the GST in respect of the input tax credit was paid or became payable by the taxpayer if the GST was paid or became payable in the same reporting period under the *Excise Tax Act* in which the input tax credit was claimed. If a taxpayer does not claim the input tax credit in the same reporting period in which the GST was paid or became payable, subparagraph 248(16)(*a*)(ii) includes the amount of assistance in the taxpayer's income for the taxation year that includes the end of the reporting period in which the taxpayer claimed the input tax credit.

Subsection 248(16) is amended in three respects for input tax credits that become eligible to be claimed in taxation years that begin after Announcement Date.

First, subparagraph 248(16)(*a*)(i) is amended to extend its application to cases where the input tax credit is claimed by a taxpayer in a reporting period that is subsequent to the period in which the related GST was paid or became payable if

- the taxpayer's threshold amount (as determined under subsection 249(1) of the *Excise Tax Act*) is $500,000 or more for the taxpayer's fiscal year (as defined by that Act) that includes the earlier of the time that the GST in respect of the input tax credit was paid and the time that it became payable, and

- the taxpayer claimed the input tax credit at least 120 days before the end of the normal reassessment period (as determined under subsection 152(3.1) of the *Income Tax Act*) for the taxpayer in respect of the taxation year that includes that earlier time.

In general, the change to this subparagraph means that an input tax credit of a taxpayer (who is a GST filer with a threshold amount of at least $500,000 for GST purposes) is considered to have been received at the time the related GST was paid or became payable, even though the input tax credit is claimed in a later GST reporting period. However, this is the case only if the taxpayer claims the input tax credit at least 120 days before the taxation year in which the GST was paid or became payable becomes statute-barred for income tax purposes.

Second, subparagraph 248(16)(*a*)(ii) is amended to provide that an input tax credit is considered to be received at the end of the reporting period in which it is claimed only if

- subparagraph 248(16)(*a*)(i) does not apply, and

- the taxpayer's threshold amount (as determined under subsection 249(1) of the *Excise Tax Act*) is less than $500,000 for the fiscal year of the taxpayer that includes the earlier of the time that the GST in respect of the input tax credit was paid or became payable.

Thus, subparagraph 248(16)(*a*)(ii) does not apply if subparagraph 248(16)(*a*)(i) applies. Where subparagraph 248(16)(*a*)(i) does not apply, subparagraph 248(16)(*a*)(ii) provides that the input tax credit is considered to have been received at the end of the reporting period in which it is claimed only if the taxpayer's threshold amount for GST purposes was less than $500,000 at the time the GST was paid or became payable.

Third, new subparagraph 248(16)(*a*)(iii) is added to apply in any other case. If applicable, that subparagraph provides that the input tax credit is considered to have been received on the last day of the taxpayer's earliest taxation year

- that begins after the taxation year that includes the earlier of the time that the GST in respect of the input tax credit was paid and the time that it became payable, and
- for which the normal reassessment period for the taxpayer ends at least 120 days after the time at which the input tax credit was claimed.

Reference should also made to the commentary to new subsection 248(17.1) of the *Income Tax Act* which provides a special rule in respect of the timing of a claim in respect of certain input tax credits assessed under the *Excise Tax Act*.

Application of Subsection (16) to Passenger Vehicles and Aircraft

ITA
248(17)

Subsection 248(17) of the *Income Tax Act* applies in the case of an input tax credit in respect of a passenger vehicle or aircraft claimable by an individual or partnership where the credit is determined by reference to capital cost allowance in respect of the vehicle or aircraft (i.e., where there is less than exclusive use in commercial activity). Subsection 248(17) is amended to reflect the amendments made to subsection 248(16) as described in the commentary to that subsection.

The amendments to subsection 248(17) apply in respect of input tax credits that become eligible to be claimed in taxation years that begin after Announcement Date.

Input Tax Credit on Assessment

ITA
248(17.1)

New subsection 248(17.1) of the Act determines, in respect of input tax credits that become eligible to be claimed in taxation years that begin after Announcement Date, the time at which an input tax credit is considered to have been claimed in respect of certain input tax credit assessments made under the *Excise Tax Act* (ETA).

This subsection provides that, if an amount in respect of an input tax credit is deemed by subsection 296(5) of the ETA to have been claimed in a return or application filed under Part IX of that Act, the input tax credit is deemed to have been claimed for the GST reporting period that includes the time the Minister of National Revenue makes the GST assessment.

Accordingly, the rule in clause 248(16)(*a*)(i)(A) of the *Income Tax Act* (ITA) relating to the time at which an input tax credit is considered to have been received cannot apply to an input tax credit to which subsection 296(5) of the ETA applies. However, the other rules in paragraph 248(16)(*a*) of the ITA that determine the time at which an input tax credit is received are to be applied on the basis that an input tax credit (to which subsection 296(5) of the ETA applies) is not claimed by the taxpayer until the reporting period that includes the time at which the input tax credit is actually assessed – i.e., not the reporting period to which the assessment relates but the reporting period in which the input tax credit is deemed to be claimed for GST purposes.

Cost of Trust Interest

ITA
248(25.3)

Subsection 248(25.3) of the *Income Tax Act* applies where a trust (other than a personal trust or a trust prescribed for the purpose of subsection 107(2) of the Act) issues particular units of the trust to a taxpayer directly in satisfaction of a right to a qualifying amount payable from the trust in respect of the taxpayer's capital interest in the trust. In such a case, the cost to the taxpayer of the particular units is deemed to equal the amount so payable. Subparagraph 248(25.3)(*c*)(i) provides that in the case of particular units of a trust that are capital property, a qualifying amount payable is one that causes, or but for clauses 53(2)(*h*)(i.1)(A) and (B) would cause, a reduction under subparagraph 53(2)(*h*)(i.1) of the Act to the adjusted cost base of the taxpayer's capital interest in the trust.

Subparagraph 248(25.3)(*c*)(i) is amended to provide that, in the case of particular units of a trust that are capital property, a qualifying amount payable is an amount payable that does not represent proceeds of disposition of a capital interest in the trust.

This amendment applies to trust units issued after Announcement Date.

Gifts and Contributions

ITA
248(30), (31), and (32)

At common law, it is generally the view that a gift includes only a property transferred voluntarily, without any contractual obligation and with no advantage of a material character returned to the transferor.

In contrast, under section 1806 of the *Civil Code of Quebec* ("CCQ"), a gift in Quebec is a contract by which ownership of property is transferred by gratuitous title. However, the rights of ownership may be separated, such that it may be possible for a transferor to transfer part of the rights of ownership without any material advantage returned (i.e., by way of gift) and to transfer the other part separately for consideration. It is therefore possible, in Quebec, to sell a property to a charity at a price below fair market value, resulting in a gift of the difference.

Under both the common law and the CCQ, it is generally accepted that a transfer of property is not a gift unless the donor is impoverished by the transfer to the benefit of the donee and it is the donor's intention to enrich the donee without consideration.

At common law there is generally no ability to separate the rights of ownership of a single property in the course of making a gift. As such, at common law a contract to dispose of a property to a charity at a price below fair market value would not generally be considered to include a gift.

Nevertheless, there have been certain decisions made under the common law where it has been found that a transfer of property to a charity was made partly in consideration for services and partly as a gift.

Subsections 248(30), (31) and (32) are added to the Act to clarify the circumstances under which taxpayers and donees may be eligible for tax benefits available under the Act in respect of the impoverishment of a taxpayer in favour of a donee. In addition to the clarification provided by these new rules, the Canada Customs and Revenue Agency will release guidelines that describe how it will apply the new rules to various situations and fundraising methods commonly used in the charitable sector.

Eligible Amount of Gift

ITA
248(30)

New subsection 248(30) of the Act, which applies in respect of gifts made after Announcement Date, defines the eligible amount of a gift as the amount by which the fair market value of the property that is the subject of the gift exceeds the amount of the advantage, if any, in respect of the gift. Subsection 248(30) is added concurrently with amendments to subsections 110.1(1) and 118.1(1) of the Act, which describe the types of gifts in respect of which an eligible amount will qualify for a deduction (for corporations) or a tax credit (for individuals). The amount of the advantage in respect of a gift is described in new subsection 248(31) of the Act.

It is proposed that subsections 3501(1), (1.1) and (6) of the Regulations be amended to provide that official receipts issued by a registered organization in respect of a gift made after Announcement Date contain, in addition to the information already prescribed, the eligible amount of the gift.

Amount of Advantage

ITA
248(31)

New subsection 248(31), which applies in respect of gifts made after Announcement Date, describes the amount of an advantage in respect of a gift or contribution as, in general, the total value of all property, services, compensation or other benefits to which the donor of a property is entitled as partial consideration for, or in gratitude for, the gift or contribution. The advantage may be contingent or receivable in the future, either to the donor or to a person not dealing at arm's length with the donor. It is not necessary that the advantage be receivable from the donee. (However, a tax credit or deduction resulting from a charitable donation is not considered a benefit.)

Subsection 248(31) is added concurrently with the addition of subsection 248(30) of the Act, which defines the eligible amount of a gift, and with the amendment of subsection 127(3) of the Act in respect of contributions to a political party.

It is proposed that subsections 2000(1) and (6) and 3501(1), (1.1) and (6) of the Regulations be amended to provide that official receipts issued by a registered organization or political party in respect of a gift or contribution contain, in addition to the information already prescribed, the eligible amount of the gift and the amount of the advantage, if any, in respect of the gift or contribution.

Intention to Give

ITA
248(32)

For the transfer of property to qualify as a gift, it is necessary that the transfer be voluntary and with the intention to make a gift. At common law, where the transferor of the property has received any form of consideration or benefit, it is generally presumed that such an intention is not present. New subsection 248(32) of the Act, which applies in respect of gifts made after Announcement Date, allows the opportunity to rebut this presumption. New paragraph 248(32)(*a*) provides that the existence of an amount of an advantage to the transferor will not necessarily disqualify the transfer from being a gift if the amount of the advantage does not exceed 80% of the fair market value of the transferred property.

> ***Example***
>
> *Mr. Short transfers land and a building with a fair market value of $300,000 to a registered charity. The charity assumes liability for an outstanding $100,000 mortgage on the property. The assumption of the mortgage by the charity does not necessarily disqualify the transfer from being a gift for the purposes of the Act.*
>
> *If the value of the mortgage is equal to the outstanding amount (e.g., the interest rate and terms and conditions are representative of current market conditions), the eligible amount of the gift, in respect of which Mr. Short may be entitled to a tax credit under subsection 118.1(3), is $200,000.*

If the amount of an advantage in respect of a transfer of property exceeds 80% of the fair market value of the transferred property, new paragraph 248(32)(*b*) provides that the transfer will not necessarily be disqualified from being a gift if the transferor can establish to the satisfaction of the Minister of National Revenue that the transfer was made with the intention to make a gift.

> *In the above example, if the amount of the mortgage outstanding had been greater than $240,000, Mr. Short (or the charity on Mr. Short's behalf) could apply to the Minister of National Revenue for a determination as to whether the transfer was made with the intention to make a gift.*

Cost of Property Acquired by Donor

ITA
248(33)

New subsection 248(33) of the Act, which applies in respect of gifts or political contributions made after Announcement Date, provides that the cost to a taxpayer of property acquired by the taxpayer in the course of the making of a gift or political contribution by the taxpayer is the fair market value of the property at the time of the making of the gift or contribution. The fair market value of such a property is relevant in computing the amount of the advantage in respect of the gift or contribution under subsection 248(31).

Clause 119

Arm's Length

ITA
251(1)

Subsection 251(1) of the Act provides a set of rules that determine whether persons are considered, for the purposes of the Act, to deal with each other at arm's length. Paragraph 251(1)(*a*) deems related persons not to deal with each other at arm's length. Paragraph 251(1)(*b*) deems a taxpayer and a personal trust (other than a trust described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1) of the Act) not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, is beneficially interested in the trust. Paragraph 251(1)(*c*) provides that, where paragraph 251(1)(*b*) does not apply, it is a question of fact whether persons not related to each other are at a particular time dealing with each other at arm's length.

Paragraph 251(1)(*c*) is amended to clarify that it applies in any case where paragraphs (*a*) and (*b*) do not apply.

This amendment applies after December 23, 1998.

Clause 120

Investments in Limited Partnerships

ITA
253.1

Section 253.1 of the Act applies for specified provisions of the Act and Regulations where a trust or corporation holds an interest as a limited partner in a limited partnership. It provides that the trust or corporation will not, solely because of its acquisition and holding of the limited partnership interest, be considered to carry on any business or other activity of the partnership.

Section 253.1 is amended so that it also applies for the purpose of paragraph 146.1(2.1)(*c*) of the Act, which provides that the registration of a registered education savings plan (RESP) is revocable if a trust governed by the plan carries on a business. The amendment to section 253.1 ensures that the acquisition and holding of a limited partnership interest by an RESP trust does not jeopardize the registered status of the plan, provided the interest is a qualified investment for the trust.

This amendment generally applies after 1997.

Clause 121

Acquisition of Control of a Corporation

ITA
256

Section 256 of the Act provides rules for determining whether corporations are to be considered to be associated and whether control of a corporation has been acquired for the purposes of the Act.

Control in Fact

ITA
256(6)

Subsection 256(6) of the Act treats a controlled corporation as not being controlled by a person or partnership if certain conditions are met.

The French version of subparagraph 256(6)(*b*)(ii) is amended to replace an erroneous reference to the « *entité dominante* » (controller) by a reference to the « *société contrôlée* » (controlled corporation), which is what was intended.

This amendment applies on Royal Assent.

Acquiring Control

ITA
256(7)

Subsection 256(7) of the Act describes circumstances in which control of a corporation will be deemed to have been acquired (or not to have been acquired) for specific provisions of the Act.

ITA
256(7)(*a*)

Paragraph 256(7)(*a*) of the Act describes the circumstances where control of a corporation (or a corporation controlled by the corporation) is considered not to have been acquired for the purposes of certain provisions of the Act. That paragraph is amended in two ways.

First, subparagraph 256(7)(*a*)(i) is amended effective with respect to the acquisition of shares after 2000 to add clause (E) which precludes an acquisition of control of a corporation on a distribution (within the meaning assigned by subsection 55(1) of the Act) by a specified corporation (within the meaning assigned by that subsection) where the dividend is received in the course of a spin-off distribution in which no portion of the dividend is treated as a capital gain by the anti-avoidance rule in subsection 55(2) of the Act because of the application of the exception for certain reorganizations under paragraph 55(3)(*b*) of the Act.

> ***Example:***
>
> *Facts:*
>
> *Pubco is a specified corporation under the butterfly rules in section 55 and a person or group of persons does not control it. Pubco owns all of the shares of Subco. In the course of a distribution (as defined by subsection 55(1)), Pubco distributes the Subco shares to Newco, which is established in the course of the reorganization for the purposes of the distribution. The same shareholders that own all of the shares of Pubco own all of the shares of Newco. Because there is no person or group of persons that control Pubco and Newco, an acquisition of control of Subco would occur upon Newco's acquisition of the Subco shares on the*

distribution despite the fact the same shareholders own Pubco and Newco.

Application:

In this example, new clause 256(7)(a)(i)(E) provides that there is no acquisition of control of Subco by Newco if Pubco's distribution of its Subco shares to Newco is a distribution to which the anti-avoidance rule in subsection 55(2) does not apply because the distribution complies with the exception in paragraph 55(3)(b).

Second, new subparagraph 256(7)(*a*)(iii), which applies to the acquisition of shares after 2000, provides that, where there is an acquisition of any shares of a corporation, there is no acquisition of control of the corporation by a related group of persons if each member of each group of persons that controls the corporation was related to the corporation immediately before the change of control.

Example:

Facts:

Corporation X has issued 100 common shares with 1 vote per share. There are no other issued shares. Mr. X owns 51% of Corporation X's issued shares. Ms. D who is the daughter of Mr. X owns 49% of the common shares issued by Corporation X. Mr. X has de jure control of Corporation X.

Mr. X disposes of 10 shares of Corporation X to Mr. Z, an arm's length person. Consequently, Mr. X no longer has de jure control, and a group of persons acquires de jure control of Corporation X.

Application:

If Mr. X and Ms. D form a related group of persons that otherwise acquires control of Corporation X upon the disposition of shares by Mr. X, new subparagraph 256(7)(a)(iii) deems no acquisition of control if no other group of persons that includes Mr. Z acquires control of Corporation X. It is a question of fact whether Mr. X and Ms. D form a group of persons that would otherwise acquire control of Corporation X and, if so, whether there exists another group of persons that also acquires control. Depending on the circumstances, Mr. X and Ms. D; Mr. X and Mr. Z; Ms. D and Mr. Z; or Mr. X, Ms. D and Mr. Z could form a group of persons that acquires control of Corporation X. Consequently, new subparagraph 256(7)(a)(iii) applies only if, in this example, Mr. X and Ms. D form a group of persons th[illegible]rol Corporation X *and there exists no other group of persons (which includes Mr. Z) that acquires control of Corporation X.*

ITA
256(7)(*e*)

Paragraph 256(7)(*e*) of the Act provides that, where certain conditions are satisfied, control of a particular corporation will be considered not to have been acquired solely because of a disposition of all of the shares of the particular corporation for consideration consisting solely of shares of the acquiring corporation. These conditions include a requirement that, immediately after the disposition, the acquiring corporation is not controlled by a person or group of persons and that the fair market value of the shares of the particular corporation is not less than 95% of the fair market value of all of the assets of the acquiring corporation.

Paragraph 256(7)(*e*) is amended, for shares acquired after 1999, to ensure that it applies on the acquisition of any shares of the capital stock of the particular corporation by the acquiring corporation if, immediately after the acquisition, the acquiring corporation owns all of the shares of the capital stock of the particular corporation (other than shares of a specified class) and the 95% test is met. This provision is also amended to deem control not to be acquired if shares of the particular corporation are acquired as part of a plan of arrangement and, upon completion of the arrangement, the acquiring corporation owns all the shares of the capital stock of the particular corporation (other than shares of a specified class) and the 95% test is met. Thus, amended paragraph 256(7)(*e*) may apply in circumstances where the acquiring corporation owns shares of the capital stock of the particular corporation before the acquisition being examined. In addition, amended paragraph 256(7)(*e*) excludes shares of a specified class, as defined in paragraph 88(1)(*c*.8) of the Act, from the determination of whether the acquiring corporation has acquired all of the shares of the particular corporation. Shares of a specified class are excluded on the basis that they are non-voting securities similar to debt and should not be considered in determining whether control has been acquired for the purpose of paragraph 256(7)(*e*).

This amendment also ensures that, in circumstances where the acquisition occurs as part of a plan of arrangement, the acquiring corporation includes a new corporation formed on an amalgamation of the acquiring corporation and a subsidiary controlled corporation of the acquiring corporation. As a result, paragraph 256(7)(*e*) may apply to a situation where the acquiring corporation owns shares of the particular corporation indirectly through a subsidiary controlled corporation if the acquiring corporation and the subsidiary controlled corporation are amalgamated as part of a plan of arrangement that includes the acquisition.

Clause 122

Proportional Holdings in Trust Property

ITA
259(1)

Subsection 259(1) of the Act provides a "look-through" rule that applies to trusts governed by registered pension plans, registered retirement savings plans and certain other tax-exempt registered plans that acquire units of a "qualified trust". If the qualified trust so elects, each registered plan trust is deemed to acquire, hold and dispose of its proportionate interest in the underlying assets of the qualified trust. This rule can benefit a registered plan trust where the direct investment in the units of the qualified trust would constitute a non-qualified investment or foreign property. By "looking through" to the underlying assets of the qualified trust, a registered plan trust may be able to reduce or eliminate the tax penalties that result from holding non-qualified investments or excessive foreign property.

Subsection 259(1) is amended so that it applies for the purpose of the registration rules for registered education savings plans (RESPs). Under subsection 146.1(2.1), the registration of an RESP is revocable if a trust governed by the plan holds a non-qualified investment. This amendment will permit an RESP trust to make a direct investment in a qualified trust that is itself a non-qualified investment, without jeopardizing the registered status of the RESP, provided the qualified trust restricts its holdings to qualified investments.

This amendment applies to the 2000 and subsequent taxation years.

Clause 123

Securities Lending Arrangements

ITA
260

Section 260 of the Act sets out special rules that apply to securities lending arrangements.

Definitions

ITA
260(1)

"securities lending arrangement"

Subsection 260(1) of the Act sets out the definition "securities lending arrangement". Paragraph (*a*) of the definition provides that in order for there to be a securities lending arrangement, the lender and the borrower of a security must be dealing at arm's length.

There are two amendments to this definition. The amendment to paragraph (*a*) extends the definition to include an arrangement entered into by non-arm's length parties. New paragraph (*e*) provides that where the lender and borrower do not deal with each other at arm's length, the arrangement must be of a term not exceeding 270 days and must not be part of a series of securities lending arrangements, loans or other transactions intended to be in effect for more than 270 days.

These amendments apply to arrangements made after 2002.

Deduction – Compensation Payments

ITA
260(6.1)(*a*)

Subsection 260(6.1) of the Act provides a deduction for dividend compensation payments made pursuant to certain dividend rental arrangements. The amount deductible is the lesser of the amount the corporation is obligated to pay as compensation under the arrangement and the amount of the dividends received by the corporation under the arrangement that were identified in its return of income as amounts which are not deductible because of subsection 112(2.3) of the Act.

Paragraph 260(6.1)(*a*) of the English version of the Act is amended, as a consequence of the amendments to the definition "dividend rental arrangement" in subsection 248(1) of the Act, by replacing a reference to paragraphs (*c*) and (*d*) of that definition to a reference to paragraph (*b*) of that definition.

This amendment applies to dividend rental arrangements made after Announcement Date and, if the parties jointly elect within 90 days after Royal Assent, it also applies to dividend rental arrangments made after November 2, 1998 and on or before Announcement Date.

Partnerships

ITA
260(10), (11)

A "securities lending arrangement" (SLA) is defined in subsection 260(1) of the Act as a particular transaction between two persons: the "lender" and the "borrower" of a security. A partnership – which for most purposes of the Act is not a person – can be a party to a transaction that would be an SLA if the partnership were a person. In such a case, it is appropriate in policy terms for the arrangement to be treated as an SLA. New subsections (10) and (11) are added to section 260 to bring partnerships within the SLA rules.

New subsection 260(10) provides that, for the purposes of section 260, a person includes a partnership. This allows a partnership to be either the borrower or the lender in respect of an SLA. The subsection also treats a partnership as a registered securities dealer, if all of its members are themselves registered securities dealers.

A transaction's status as an SLA is relevant to, among other things, the tax treatment of amounts paid and received in compensation for dividends or interest on the security that is transferred or lent. New subsection 260(11) is added to ensure the appropriate treatment of these amounts in a case where a corporation is a member of a partnership that has entered into an SLA.

- Under new paragraph 260(11)(*a*), the corporation is treated for the purpose of subsection 260(5) as having received its "specified proportion" (now defined in subsection 248(1) of the Act) of any compensation payments that are described in subsection 260(5) and were received by the partnership. It is also treated as being the same person as the partnership, thus ensuring that the partnership's reasons for entering into the arrangement (which are relevant to the applicability of the subsection) are attributed to the corporation.

- New paragraph 260(11)(*b*) treats the corporation as being obligated to pay its specified proportion of a dividend compensation payment described in paragraph 260(6.1)(*a*).

- New paragraph 260(11)(*c*) treats the corporation, for the purpose of applying the dividend refund rules in section 129 of the Act, as having paid its specified proportion of the non-deductible dividend compensation payment made by the partnership.

These amendments apply to securities lending arrangements made after Announcement Date and, if the parties jointly elect within 90 days after Royal Assent, they also apply to securities lending arrangements made after November 2, 1998 and on or before Announcement Date.

Clause 124

ITA
Schedule

For information about this new schedule, see the commentary to subsection 181(1) of the Act.

Amendments to the Federal – Provincial Fiscal Arrangements Act

Clause 125

Deduction for Federal Tax

FPFAA
12.2

Part IV.1 of the *Federal-Provincial Fiscal Arrangements Act* (FPFAA) provides a revenue-sharing mechanism in respect of the tax collected under Part VI.1 of the *Income Tax Act (Canada)* (ITA). A province is entitled to a portion of the federal tax collected from corporations that operate in the province in a year, if two conditions are met. First, it must be the case either that Canada collects the province's corporate income tax under a tax collection agreement, or that the province's law allows a multiple of the Part VI.1 tax to be deducted in computing taxable income. Second, the province itself must not impose taxes similar to those imposed under Parts IV.1 and VI.1 of the ITA.

The condition that the province itself provide a deduction is currently set out, in paragraph 12.2(1)(*b*) of the FPFAA, as requiring a deduction of at least 9/4 of a corporation's ITA Part VI.1 tax. The 9/4 figure is taken from the deduction under ITA paragraph 110(1)(*k*). With the adjustment of that ITA deduction, the figure 9/4 is no longer appropriate. Paragraph 12.2(1)(*b*) of the FPFAA is, therefore, amended to require a deduction, for provincial tax purposes, that is not less than the amount deductible under the ITA provision. By referring to the ITA rule itself, rather than specifying a given figure, amended paragraph 12.2(1)(*b*) will not need to be further amended if the multiple provided in the ITA should change at some future time.

To ensure that provinces have an opportunity to make any necessary amendments to provincial legislation, this amendment applies after 2003.

Income Tax Amendments Act, 2002

Clause 126

S.C. 2000, c. 17, ss. 59(2)

Debt Forgiveness Rules

Subsection 59(2) of the *Income Tax Amendments Act, 2000* is amended to provide that, in computing a debtor's income for a particular taxation year, the fraction in paragraph 38(*a*) of the *Income Tax Act* to be applied in respect of the settlement of a commercial debt obligation is the fraction in that paragraph that applied to the debtor in the debtor's taxation year in which the obligation was deemed to have been settled instead of the fraction in that paragraph that applies to the debtor in the particular taxation year.

This change corrects a technical deficiency, and is deemed to have come into force on June 14, 2001.

Clause 127

S.C. 2000, c. 17, ss. 70(11)

Disposition of Shares in a Foreign Affiliate

ITA
93(1.2)

Section 93 of the *Income Tax Act* contains a number of rules relating to the disposition of shares of a foreign affiliate of a taxpayer resident in Canada.

Subsection 93(1.2) provides that, where a particular corporation resident in Canada or a foreign affiliate of the particular corporation (each of which is referred to as the "disposing corporation") would, but for this subsection, have a taxable capital gain from a partnership from the disposition by the partnership of shares of a class of the capital stock of a foreign affiliate of the corporation, and the disposing corporation so elects in prescribed manner in respect of the gain, the amount designated will reduce the taxable capital gain and will be grossed up and recharacterized as a dividend received on the share by the disposing corporation.

Paragraph 93(1.2)(*a*) provides that twice the amount designated by the disposing corporation in respect of the shares (or where subsection 93(1.3) applies, twice the amount determined under that subsection) will be treated as a dividend received on the shares by the disposing corporation from the foreign affiliate.

Before the present amendment, subsection 93(1.2) was applicable to taxation years that end after February 27, 2000. This amendment ensures that, for a taxation year of a taxpayer that includes either February 28, 2000 or October 17, 2000 or began after February 28, 2000 and ended before October 17, 2000, the reference to the word "twice" is to read as references to the reciprocal of the capital gains inclusion rate applicable to the corporation resident in Canada or to the foreign affiliate for the taxation year. This amendment corrects a technical deficiency.

APPENDIX A

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Authorized Foreign Banks

1. Subsection 105(2) of the *Income Tax Regulations* is replaced by the following:

(2) Subsection (1) does not apply

(*a*) to a payment described in the definition "remuneration" in subsection 100(1); nor

(*b*) to a payment made to a registered non-resident insurer (within the meaning assigned by section 804) or to an authorized foreign bank.

2. Sections 800 to 803 of the Regulations are replaced by the following:

NON-RESIDENT BANKS AND INSURERS

800. Subsections 215(1), (2) and (3) of the Act do not apply to amounts paid or credited to an authorized foreign bank or to a registered non-resident insurer.

801. A taxpayer that is an authorized foreign bank or a registered non-resident insurer at any time in a taxation year shall file a return in respect the year in prescribed form with the Minister on or before its filing-due date for the year.

802. The amounts that are taxable under Part XIII of the Act in a taxation year of a taxpayer that is an authorized foreign bank or a registered non-resident insurer are amounts paid or credited to the taxpayer in the year other than amounts included under Part I of the Act in computing the taxpayer's income from a business carried on by it in Canada.

803. Authorized foreign banks and registered non-resident insurers shall pay to the Receiver General, on or before their filing-due dates for a taxation year, the tax payable by them under Part XIII of the Act.

3. Section 805 of the Regulations is replaced by the following:

OTHER NON-RESIDENT PERSONS

805. Subject to section 802, every non-resident person who carries on business in Canada is taxable under Part XIII of the Act on all amounts otherwise taxable under that Part except those amounts that

(*a*) can reasonably be attributed to the business carried on by the person through a permanent establishment (within the meaning assigned by subsection 400(2) or that would be assigned by that subsection if the person were a corporation) in Canada; or

(*b*) are required by subparagraph 115(1)(*a*)(iii.3) of the Act to be included in computing the person's taxable income earned in Canada for the year.

4. Section (1) applies to amounts paid after June 27, 1999.

5. Sections 2 and 3 apply to taxation years that end after June 27, 1999, except that the return required to be filed under section 801, as enacted by section 1, by an authorized foreign bank is deemed to have been filed with the Minister of National Revenue in a timely manner if it is so filed on or before the later of

(*a*) the day on or before which it would, but for this subsection, be required to be filed; and

(*b*) the day that is 6 months after the day on which this Regulation is registered.

AUTHORIZED FOREIGN BANKS

EXPLANATORY NOTES

ITR
105(2)

Part I of the *Income Tax Regulations* provides the rules concerning the amounts to be withheld on account of tax by a person who pays any of certain amounts. Subsection 105(1) of the Regulations requires that 15% be withheld from payments made to a non-resident in respect of services rendered in Canada. Subsection 105(2) excludes "remuneration" (defined in subsection 100(1) of the Regulations) from this withholding.

Subsection 105(2) is to be amended to exclude from the subsection 105(1) withholding requirement payments made to an authorized foreign bank or to a registered non-resident insurer (within the meaning assigned by section 804 of the Regulations).

This amendment is to apply to payments made after June 27, 1999.

ITR
800

Part VIII of the *Income Tax Regulations* includes rules that relate to taxes on non-resident persons.

Section 800 of the Regulations provides that amounts paid or credited to a registered non-resident insurer are not subject to the withholding obligations set out in subsections 215(1), (2) and (3) of the Act. The section is to be amended to apply as well to amounts paid or credited to an authorized foreign bank, and to update its structure.

This amendment is to apply to payments made in taxation years that end after June 27, 1999.

ITR
801

Section 801 of the Regulations requires a non-resident insurer to file a return in respect of tax payable by it under Part XIII of the Act. The section is to be amended to apply the same requirement to an authorized foreign bank.

This amendment is to apply to taxation years that end after June 27, 1999, except that the return required to be filed by an authorized foreign bank is deemed to have been filed with the Minister of National Revenue in a timely manner if it is filed on or before the later of

- the day on or before which it would otherwise be required to be filed (that is, the bank's filing-due date for the taxation year in question); and
- the day that is 6 months after the day on which this Regulation is registered.

ITR
802

Section 802 of the Regulations ensures that Parts I and XIII of the Act do not overlap in respect of a registered non-resident insurer's income from carrying on business in Canada. In general terms, the section provides that, to the extent such income is dealt with by Part I, it is not subject to taxation under Part XIII. In its current form, section 802 is not clearly confined to registered non-resident insurers. As a result, its relationship to section 805, which deals with the same subject in respect of other taxpayers, is also unclear.

Section 802 is to be amended to clarify its application, and to provide that it applies as well to authorized foreign banks. This amendment is to apply to taxation years that end after June 27, 1999.

ITR
803

Section 803 of the Regulations provides that a registered non-resident insurer must pay its Part XIII tax owing in respect of a taxation year on or before the day on which its return under Regulation 801 in respect of the year is due. The section is to be amended to clarify its scope and meaning, and to provide that it is to apply as well to authorized foreign banks. This amendment is to apply to taxation years that end after June 27, 1999.

ITR
805

Section 805 of the Regulations provides rules for determining whether an amount is taxable under Part XIII of the Act, in a case where the non-resident recipient of the amount carries on a business in Canada. In general terms, the section provides that an amount paid to a non-resident is taxable under Part XIII of the Act if that amount cannot reasonably be attributed to a business carried on by the non-resident through a permanent establishment in Canada.

Section 805 is to be amended to update its structure and language, and to clarify its relationship to section 802 of the Regulations – in effect, that section 805 is not applicable to authorized foreign banks and registered non-resident insurers.

This amendment is to apply to taxation years that end after June 27, 1999.

APPENDIX B

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Excluded Property of Non-Resident Persons

1. Section 810 of the *Income Tax Regulations* is repealed.

2. Section 1 applies after June 27, 1999.

EXCLUDED PROPERTY OF NON-RESIDENT INSURERS

EXPLANATORY NOTES

ITR
810

Section 810 of the *Income Tax Regulations* prescribes as "excluded property" for the purposes of paragraph 116(6)(*e*) of the Act the properties (including options and interests in respect of property) of certain non-resident insurers. As a result of an earlier amendment to paragraph 116(6)(*e*), that paragraph (together with paragraphs 116(6)(*g*) and (*h*)) now contains the substance of section 810, and section 810 can be repealed. This repeal is proposed to take effect after June 27, 1999.

APPENDIX C

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Capital Cost Allowance – Vessels

1. Section 1101 of the *Income Tax Regulations* is amended by adding the following after subsection (2b):

Vessels and a Structured Financing Facility

(2c) Subsections (2a) and (2b) do not apply to a vessel, nor to the furniture, fittings, radio communications equipment and other equipment attached to the vessel, if a structured financing facility relating to any such property has been agreed to by the Minister of Industry under the *Department of Industry Act.*

2. The portion of paragraph (*b*) of Class 41 in Schedule II to the Regulations before subparagraph (i) is replaced by the following:

(*b*) that is property, other than property described in subsection 1101(2c),

3. Sections 1 and 2 are deemed to have come into force on November 7, 2001.

CAPITAL COST ALLOWANCE – VESSELS

EXPLANATORY NOTES

ITR
1101

Section 1101 of the *Income Tax Regulations* provides separate classes in respect of certain property described in Schedule II to the Regulations.

ITR
1101(2c)

In general, capital cost allowance Class 7 in Schedule II to the Regulations applies to vessels and attachments thereto (15% rate, declining balance method). However, an additional allowance is available under Regulations 1100(1)(*v*) and (*va*) in respect of certain vessels and their attachments. In particular, this is the case where a vessel and its attachments are included in a separate class because of subsection 1101(2a) or (2b) of the Regulations. As well, Class 41 (25% rate, plus an additional allowance) applies to vessels and attachments thereto if paragraph (*b*) of Class 41 applies.

Proposed new subsection 1101(2c) of the Regulations provides that the separate classes in subsections 1101(2a) and (2b) for vessels and attachments do not apply in cases where the Minister of Industry has agreed to a structured financing facility. This change is consequential to the creation of the Structured Financing Facility Program, which is administered by Industry Canada. In cases where a vessel or its attachments are financed with a benefit under the Structured Financing Facility Program, the maximum capital cost allowance rate applicable to the vessel and its attachments is 15% under Class 7.

For additional information, see the commentary to the amendment to Class 41.

This amendment applies after November 7, 2001.

ITR
Class 41, Schedule II

Capital cost allowance Class 41 in Schedule II to the Regulations is amended to exclude from paragraph (*b*) property described in subsection 1101(2c) of the Regulations. This amendment is consequential to new subsection 1101(2c), and the Structured Financing Facility Program for new Canadian built vessels administered by Industry Canada.

This amendment applies after November 7, 2001.

APPENDIX D

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Foreign Affiliates

1. Section 5902 of the *Income Tax Regulations* is amended by adding the following after subsection (6):

(7) If an election under subsection 93(1) or (1.2) of the Act is made at any time by a corporation resident in Canada in respect of a share of the capital stock of a foreign affiliate of the corporation (in this subsection referred to as the "particular affiliate") that is disposed of to the corporation, to another corporation resident in Canada with which the corporation does not deal at arm's length or to another foreign affiliate of the corporation, the amount of the particular affiliate's exempt surplus or exempt deficit, taxable surplus or taxable deficit, underlying foreign tax and net surplus in respect of the corporation at that time is to be determined under paragraph (1)(*a*) as if the amount of any dividend referred to in subparagraph (1)(*a*)(i) or (ii) were nil.

2. (1) Section 5905 of the Regulations is amended by adding the following after subsection (5):

Amalgamations and Windings-up – Opening Exempt Surplus

(5.1) In the case of an amalgamation described in paragraph (5)(*b*) to which subsection 87(11) of the Act applies and of a winding-up described in paragraph (5)(*c*), the particular affiliate's opening exempt surplus in respect of the acquiring corporation, as determined under paragraph (5)(*d*), is to be decreased by the lesser of

(*a*) the total of all amounts, each of which is the amount, if any, that is

(i) determined under paragraph 88(1)(*d*) of the Act in applying subsection 87(11) of the Act in respect of the shares of the capital stock of the particular affiliate that, as a result of that amalgamation, became the property of the acquiring corporation, or

(ii) determined under paragraph 88(1)(*d*) of the Act in respect of the shares of the capital stock of the particular affiliate that, as a result of that winding-up, became the property of the acquiring corporation, and (*b*) the particular affiliate's opening exempt surplus in respect of the predecessor corporation as otherwise determined under paragraph (5)(*d*).

Amalgamations and Windings-up – Opening Taxable Surplus

(5.2) In the case of an amalgamation described in paragraph (5)(*b*) to which subsection 87(11) of the Act applies and of a winding-up described in paragraph (5)(*c*), the particular affiliate's opening taxable surplus in respect of the acquiring corporation as determined under paragraph (5)(*f*) is to be decreased by the least of

(*a*) the amount, if any, by which the amount determined under paragraph (5.1)(*a*) exceeds the amount of the decrease determined under subsection (5.1),

(*b*) the particular affiliate's taxable surplus in respect of the predecessor corporation as otherwise determined under paragraph (5)(*f*), and

(*c*) the amount determined by the formula

$$A \times B$$

where

A is the amount that would be the particular affiliate's underlying foreign tax in respect of the acquiring corporation determined under paragraph (5)(*h*) if the Regulations were read without reference to subsection (5.4), and

B is the relevant tax factor (as defined in subsection 95(1)) of the Act) of the acquiring corporation.

Amalgamations and Windings-up – Opening Exempt Deficit

(5.3) In the case of an amalgamation described in paragraph (5)(*b*) to which subsection 87(11) of the Act applies and of a winding-up described in paragraph (5)(*c*), the particular affiliate's opening exempt deficit in respect of the acquiring corporation as determined under paragraph (5)(*e*) is to be increased by the amount, if any, by which

(*a*) the amount determined under paragraph (5.1)(*a*)

exceeds

(*b*) the total of all amounts each of which is an amount of a decrease determined under subsection (5.1) or (5.2).

Amalgamations and Windings-up – Opening Underlying Foreign Tax

(5.4) In the case of an amalgamation described in paragraph (5)(*b*) to which subsection 87(11) of the Act applies and of a winding-up described in paragraph (5)(*c*), the particular affiliate's opening underlying foreign tax in respect of the acquiring corporation as determined under paragraph (5)(*h*) is to be decreased by the amount, if any, determined by the formula

$$A / B$$

where

A is the amount of the decrease determined under subsection (5.2); and

B is the relevant tax factor (as defined in subsection 95(1)) of the Act) of the acquiring corporation for the taxation year of the acquiring corporation that

(*a*) in the case of an amalgamation, ended immediately before the amalgamation, and

(*b*) in the case of a winding-up, included the time the winding-up began.

(2) Subsection 5905(7) of the Regulations is replaced by the following:

(7) If paragraph 95(2)(*e*.1) of the Act applies to a liquidation and a dissolution of a foreign affiliate (in this subsection and subsections (7.1) to (7.4) referred to as the "disposing affiliate") of a corporation resident in Canada,

(*a*) each other foreign affiliate of the corporation that has a direct equity percentage in the disposing affiliate immediately before the specified time is, for the purpose of computing its exempt surplus, exempt deficit, taxable surplus, taxable deficit and underlying foreign tax, in respect of the corporation, deemed to have received dividends immediately before that time the total of which is equal to the amount that it could reasonably have expected to receive if the disposing affiliate had, immediately before the specified time, paid dividends the total of which on all shares of its capital stock was equal to the sum of its exempt surplus, if any, and its taxable surplus, if any, in respect of the corporation immediately before that time;

(*b*) the amount, in respect of the corporation, of the exempt deficit of each other foreign affiliate of the corporation that had a direct equity percentage in the disposing affiliate immediately before the specified time is to be, immediately before that time, increased by its proportionate share of the exempt deficit, if any, of the disposing affiliate in respect of the corporation immediately before that time;

(*c*) the amount, in respect of the corporation, of the taxable deficit of each other foreign affiliate of the corporation that had a direct equity percentage in the disposing affiliate immediately before the specified time is to be, immediately before that time, increased by its proportionate share of the taxable deficit, if any, of the disposing affiliate in respect of the corporation immediately before that time;

(*d*) the amount, in respect of the corporation, of the exempt surplus of each other foreign affiliate of the corporation that had a direct equity percentage in the disposing affiliate immediately before the specified time is to be, immediately before that time, decreased by its proportionate share of the exempt deficit, if any, of the disposing affiliate in respect of the corporation immediately before that time; and

(*e*) the amount, in respect of the corporation, of the taxable surplus of each other foreign affiliate of the corporation that had a direct equity percentage in the disposing affiliate immediately before the specified time is to be, immediately before that time, decreased by its proportionate share of the taxable deficit, if any, of the disposing affiliate in respect of the corporation immediately before that time.

(7.1) The specified time in relation to a liquidation and a dissolution of a foreign affiliate mentioned in subsection (7) is the time that is the earlier of

(*a*) the time of dissolution of the disposing affiliate; and

(*b*) the time of the earliest distribution of property as part of the liquidation and the dissolution of the disposing affiliate.

(7.2) For the purpose of subsection (7), the exempt surplus, exempt deficit, taxable surplus, taxable deficit and underlying foreign tax of the disposing affiliate in respect of the corporation at any time is to be determined on the assumption that the taxation year of the disposing affiliate that otherwise would have included that time had ended immediately before that time.

(7.3) For the purpose of paragraphs (7)(*b*) and (*d*), an affiliate's proportionate share of the exempt deficit, if any, of the disposing affiliate in respect of the corporation at any time is equal to the amount it could reasonably have expected to receive if the disposing affiliate had, immediately before that time, paid a dividend equal to the amount of its exempt deficit, if any, in respect of the corporation.

(7.4) For the purpose of paragraph (7)(*c*) and (*e*), an affiliate's proportionate share of the taxable deficit, if any, of the disposing affiliate in respect of the corporation at any time is equal to the amount it could reasonably have expected to receive if the disposing affiliate had, immediately before that time, paid a dividend equal to the amount of its taxable deficit, if any, in respect of the corporation.

3. (1) Subsection 5907(1) of the Regulations is amended by replacing, with any grammatical changes that the circumstances require, in each of the following subparagraphs the reference to "subsection 5905(7)" with a reference to "subsections 5905(7) to (7.4)":

(*a*) subparagraph (iii) of the description of A in the definition "exempt surplus";

(*b*) subparagraph (iii) of the description of A in the definition "taxable surplus"; and

(*c*) subparagraph (iv) of the description of A in the definition "underlying foreign tax".

(2) Paragraph (*b*) of the definition "earnings" in subsection 5907(1) of the Regulations is replaced by the following:

(*b*) in any other case, the total of all the amounts required by paragraph 95(2)(*a*) of the Act to be included in computing the affiliate's income for the year from an active business;

(3) The portion of the definition « gains exonérés » in subsection 5907(1), of the French version of the Regulations, before paragraph (*a*) is replaced by the following:

« gains exonérés » En ce qui concerne une société étrangère affiliée d'une société pour une année d'imposition de la société affiliée, le total des montants représentant chacun l'un des montants suivants, moins la partie de l'impôt sur le revenu ou sur les bénéfices payé par la société affiliée pour l'année au gouvernement d'un pays qu'il est raisonnable de considérer comme un impôt sur les gains visés à l'alinéa c) ou au sous-alinéa d)(ii) :

(4) The portion of paragraph (*a*) of the definition « gains exonérés » in subsection 5907(1), of the French version of the Regulations, after subparagraph (iii) is replaced by the following:

pour l'application du présent alinéa, lorsque la société affiliée a disposé d'immobilisations qui étaient des actions du capital-actions d'une autre société étrangère affiliée de la société donnée en faveur d'une autre société qui était, immédiatement après la disposition, une société étrangère affiliée de la société donnée, est exclue des gains en capital de la société affiliée pour l'année la fraction de ces gains qui correspond au total des montants représentant chacun l'excédent de la juste valeur marchande, à la fin de l'année d'imposition 1975 de la société affiliée, de l'une des actions dont il a été disposé sur son prix de base rajusté;

(5) The definition "exempt earnings" in subsection 5907(1) of the Regulations is amended by adding the following after paragraph (*a*):

(*a*.1) in respect of each disposition in the year of excluded property that is eligible capital property, the amount by which

(i) 50% of the amount, if any, by which the particular affiliate's proceeds of disposition of the property disposed of exceed the particular affiliate's cost of that property,

exceeds

(ii) that portion of the amount determined in accordance with subparagraph (i) that has otherwise been included in the particular affiliate's exempt earnings for the year,

(6) Subparagraph (*d*)(ii) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is replaced by the following:

(ii) the earnings of the particular affiliate for the year from an active business to the extent that they derive from

(A) amounts required to be included in computing the income of the particular affiliate from an active business for the year because of subparagraph 95(2)(*a*)(i) of the Act that are derived by the particular affiliate from activities that can reasonably be considered to be directly related to business activities carried on by a non-resident corporation, to which the particular affiliate and the particular corporation are related throughout the year, in the course of an active business carried on by the non-resident corporation the income or loss from which would, if the non-resident corporation were a foreign affiliate of a corporation, be included in computing the non-resident corporation's exempt earnings or exempt loss,

(B) if the particular corporation is a life insurance corporation resident in Canada throughout the year and the particular affiliate is a foreign affiliate in respect of which the particular corporation has a qualifying interest throughout the year, amounts required to be included in computing the income of the particular affiliate from an active business for the year because of subparagraph 95(2)(*a*)(i) of the Act that are derived by the particular affiliate from activities that can reasonably be considered to be directly related to business activities carried on by the particular corporation in the course of an active business carried on by the particular corporation in a country other than Canada, the income or loss from which would, if the particular corporation were a foreign affiliate of another corporation and were resident in the country other than Canada in which that active business of the particular corporation is carried on, be included in computing the particular corporation's exempt earnings or exempt loss,

(C) amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that, if the non-resident corporation were a foreign affiliate of a corporation, the amounts paid or payable by the non-resident corporation would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(D) if a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the non-resident corporation is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(E) amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year, to the extent that the amounts paid or payable by the other foreign affiliate are deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(F) if another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the other foreign affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(G) if the particular affiliate is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(C) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the particular affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or a subsequent taxation year,

(H) amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(D) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by another foreign affiliate (in this clause referred to as the "second affiliate") of the particular corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the amounts paid or payable

(I) are on account of interest on borrowed money used for the purpose of earning income from property or interest on an amount payable for property, if

1. the property is shares of a foreign affiliate (in this clause referred to as the "third affiliate") of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year and that are excluded property, and

2. the second affiliate and the third affiliate are resident in the same designated treaty country for each of their taxation years (each of which taxation years is referred to in this sub-subclause and sub-subclause (II)2 as a "relevant taxation year" of the second affiliate or of the third affiliate, as the case may be) that end in the year and, in respect of each of the second affiliate and the third affiliate for each relevant taxation year of that affiliate, either that affiliate is subject to income taxation in that country in that relevant taxation year or, alternatively, the members or shareholders of that affiliate at the end of that relevant taxation year are subject to income taxation in that country on, in

aggregate, all or substantially all of the income of that affiliate for that relevant taxation year in their taxation years in which that relevant taxation year ends or would be so subject to income taxation in that country if that affiliate had income for that relevant taxation year and the income of those members or shareholders for their taxation years in which that relevant taxation year ends consisted only of their share of income of that affiliate for that relevant taxation year, and

(II) are relevant in computing the income for income tax purposes, in the designated treaty country in which the second and third affiliates are resident,

1. of the members (each of which members is referred to in this sub-subclause as a "group member") of a group of corporations, if the group is composed of the second affiliate and of one or more other foreign affiliates of the taxpayer (each of which other foreign affiliates is referred to in this sub-subclause as a "group affiliate"), the taxpayer has a qualifying interest in respect of each group affiliate throughout the year, the second affiliate and each group affiliate would (if the reference in sub-subclause (I)2 to "third affiliate" were read as a reference to "group affiliate") meet the requirements of that sub-subclause in the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of a group member, from a source in a particular place, for a taxation year of that group member that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country, or

2. of the second affiliate, if the third affiliate meets the requirements of sub-subclause 95(2)(a)(ii)(D)(V)2 of the Act in each relevant taxation year of the third affiliate, the taxpayer has a qualifying interest in respect of the third affiliate throughout the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of the third affiliate, from a source in a particular place, for a

taxation year of the third affiliate that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country,

where, for the purpose of this clause,

(III) "excluded property" has the meaning that would be assigned by subsection 95(1) of the Act if paragraph (*c*) of the definition "excluded property" in that subsection were read as follows:

"(*c*) property all or substantially all of the income from which is, or would be, if there was income from the property,

(i) income from an active business by reason of paragraph (2)(*a*) if that paragraph were read without reference to subparagraph (2)(*a*)(v), and

(ii) income derived from amounts payable by payors who are entitled to deduct the amounts in computing their exempt earnings or exempt loss (as those expressions are defined in Regulations made for the purpose of section 113),"

and

(IV) the particular corporation has a qualifying interest in respect of another corporation if the particular corporation has, because of paragraph 95(2)(*m*) or (*m*.1) of the Act, a qualifying interest in respect of that other corporation for the purpose of subdivision i of Division B of Part I of the Act,

(I) if the particular corporation is a life insurance corporation resident in Canada (in this clause referred to as the "insurer"), a corporation controlled by the insurer or a corporation that controls the insurer and the particular affiliate is a foreign affiliate in respect of which the particular corporation has a qualifying interest throughout the year, amounts required to be included in computing the particular affiliate's income from an active business for the year because of clause 95(2)(*a*)(ii)(E) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by the insurer in the course of carrying on its life insurance business outside Canada, to the extent that, if the insurer were a foreign affiliate of another corporation resident in Canada and were resident in the country in which the insurer carried on its life insurance business outside Canada, the amounts paid or payable by the insurer would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(J) amounts required to be included in computing the particular affiliate's income from an active business for the year because of subparagraph 95(2)(*a*)(iii) of the Act that are derived from the factoring of trade accounts receivable acquired by the particular affiliate, or by a partnership of which the particular affiliate was a member, from a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the trade accounts receivable arose in the course of an active business carried on by the non-resident corporation any income from which would be included in computing the exempt earnings of the non-resident corporation if it were a foreign affiliate of a corporation,

(K) amounts required to be included in computing the particular affiliate's income from an active business for the year because of subparagraph 95(2)(*a*)(iv) of the Act that are derived from loans or lending assets acquired by the particular affiliate, or by a partnership of which the particular affiliate was a member, from a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the loans or lending assets arose in the course of an active business carried on by the non-resident corporation any income from which would be included in the exempt earnings of the non-resident corporation if it were a foreign affiliate of a corporation,

(L) amounts required to be included in computing the particular affiliate's income for the year from an active business because of subparagraph 95(2)(*a*)(v) or (vi) of the Act, or

(7) The portion of the definition "exempt loss" in subsection 5907(1) of the Regulations before paragraph (*a*) is replaced by the following:

"exempt loss" of a foreign affiliate of a particular corporation for a taxation year of the affiliate is the total of all amounts each of which is

(8) The definition "exempt loss" in subsection 5907(1) of the Regulations is amended by adding the following after paragraph (*a*):

(*a*.1) in respect of each disposition in the year of excluded property that is eligible capital property, the amount by which

(i) 50% of the amount, if any, by which the affiliate's cost of the property exceeds the affiliate's proceeds of disposition of the property

exceeds

(ii) that portion of the amount determined in accordance with subparagraph (i) that has otherwise been included in the affiliate's exempt loss for the year,

(9) Paragraph (*c*) of the definition "exempt loss" in subsection 5907(1) of the Regulations is replaced by the following:

(*c*) where the year is the 1976 or any subsequent taxation year of the affiliate (referred to in this paragraph as the "particular affiliate") and the particular affiliate is resident in a designated treaty country, each amount that is

(i) the particular affiliate's net loss for the year from an active business carried on by it in Canada or in a designated treaty country, or

(ii) the losses of the particular affiliate for the year from an active business to the extent that they derive from

(A) amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of subparagraph 95(2)(*a*)(i) of the Act that are derived by the particular affiliate from activities that can reasonably be considered to be directly related to business activities carried on by a non-resident corporation, to which the particular affiliate and the particular corporation are related throughout the year, in the course of an active business carried on by the non-resident corporation the income or loss from which would, if the non-resident corporation were a foreign affiliate of a corporation, be included in computing the non-resident corporation's exempt earnings or exempt loss,

(B) if the particular corporation is a life insurance corporation resident in Canada throughout the year and the particular affiliate is a foreign affiliate in respect of which the particular corporation has a qualifying interest throughout the year, amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of subparagraph 95(2)(*a*)(i) of the Act that are derived by the particular affiliate from activities that can reasonably be considered to be directly related to business activities carried on by the particular corporation in the course of an active business carried on by the particular corporation in a country other than Canada, the income or loss from which would, if the particular corporation were a foreign affiliate of another corporation and were resident in the country other than Canada in which that active business of the particular corporation is carried on, be included in computing the particular corporation's exempt earnings or exempt loss,

(C) amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that, if the non-resident corporation were a foreign affiliate of a corporation, the amounts paid or payable by the non-resident corporation would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(D) if a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the non-resident corporation is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(E) amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year, to the extent that the amounts paid or payable by the other foreign affiliate are deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(F) if another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the other foreign affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(G) if the particular affiliate is a qualifying member of a particular partnership at any time in a fiscal period of the particular partnership that ends in the year, amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(C) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the particular affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(H) amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(D) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by another foreign affiliate (in this clause referred to as the "second affiliate") of the particular corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the amounts paid or payable

(I) are on account of interest on borrowed money used for the purpose of earning income from property or interest on an amount payable for property, if

1. the property is shares of a foreign affiliate (in this clause referred to as the "third affiliate") of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year and that are excluded property, and

2. the second affiliate and the third affiliate are resident in the same designated treaty country for each of their taxation years (each of which taxation years is referred to in this sub-subclause and sub-subclause (II)2 as a "relevant taxation year" of the second affiliate or of the third affiliate, as the case may be) that end in the year and, in respect of each of the second affiliate and the third affiliate for each relevant taxation year of that affiliate, either that affiliate is subject to income taxation in that country in that relevant taxation year or, alternatively, the members or shareholders of that affiliate at the end of that relevant taxation year are subject to income taxation in that country on, in aggregate, all or substantially all of the income of that affiliate for that relevant taxation year in their taxation years in which that relevant taxation year ends or would be so subject to income taxation in that country if that affiliate had income for that relevant taxation year and the income of those members or shareholders for their taxation years in which that relevant taxation year ends consisted only of their share of income of that affiliate for that relevant taxation year, and

(II) are relevant in computing the income for income tax purposes, in the designated treaty country in which the second and third affiliates are resident,

1. of the members (each of which members is referred to in this sub-subclause as a "group member") of a group of corporations, if the group is composed of the second affiliate and of one or more other foreign affiliates of the taxpayer (each of which other foreign affiliates is referred to in this sub-subclause as a "group affiliate"), the taxpayer has a qualifying interest in respect of each group affiliate throughout the year, the second affiliate and each group affiliate would (if the reference in sub-subclause (I)2 to "third affiliate" were read as a reference to "group affiliate") meet the requirements of that sub-subclause in the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of a group member, from a source in a particular place, for a taxation year of that group member that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country, or

2. of the second affiliate, if the third affiliate meets the requirements of sub-subclause 95(2)(a)(ii)(D)(V)2 of the Act in each relevant taxation year of the third affiliate, the taxpayer has a qualifying interest in respect of the third affiliate throughout the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of the third affiliate, from a source in a particular place, for a taxation year of the third affiliate that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country

where, for the purpose of this clause,

(III) "excluded property" has the meaning assigned to that expression for the purpose of clause (*d*)(ii)(H) of the definition "exempt earnings", and

(IV) the particular corporation has a qualifying interest in respect of another corporation if the particular corporation has, because of paragraph 95(2)(*m*) or (*m*.1) of the Act, a qualifying interest in respect of that other corporation for the purpose of subdivision i of Division B of Part I of the Act,

(I) if the particular corporation is a life insurance corporation resident in Canada (in this clause referred to as the "insurer"), a corporation controlled by the insurer or a corporation that controls the insurer and the particular affiliate is a foreign affiliate in respect of which the particular corporation has a qualifying interest throughout the year, amounts required to be included in computing the particular affiliate's loss from an active business for the year because of clause 95(2)(*a*)(ii)(E) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to a partnership of which it is a member by the insurer in the course of carrying on its life insurance business outside Canada, to the extent that, if the insurer were a foreign affiliate of another corporation resident in Canada and were resident in the country in which the insurer carried on its life insurance business outside Canada, the amounts paid or payable by the insurer would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(J) amounts required to be included in computing the particular affiliate's loss from an active business for the year because of subparagraph 95(2)(*a*)(iii) of the Act that are derived from the factoring of trade accounts receivable acquired by the particular affiliate, or by a partnership of which the particular affiliate was a member, from a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the trade accounts receivable arose in the course of an active business carried on by the non-resident corporation any income from which would be included in computing the exempt earnings of the non-resident corporation if it were a foreign affiliate of a corporation,

(K) amounts required to be included in computing the particular affiliate's loss from an active business for the year because of subparagraph 95(2)(*a*)(iv) of the Act that are derived from loans or lending assets acquired by the particular affiliate, or by a partnership of which the particular affiliate was a member from a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year, to the extent that the loans or lending assets arose in the course of an active business carried on by the non-resident corporation any income from which would be included in the exempt earnings of the non-resident corporation if it were a foreign affiliate of a corporation, or

(L) amounts required to be included in computing the particular affiliate's loss for the year from an active business because of subparagraph 95(2)(*a*)(v) or (vi) of the Act, or

(10) The definition "exempt loss" in subsection 5907(1) of the English version of the Regulations is amended by adding the following after paragraph (*d*):

minus the portion of any income or profits tax refunded by the government of a country for the year to the affiliate that can reasonably be regarded as tax refunded in respect of amounts of losses referred to in subparagraph (*c*)(ii);

(11) The definition "loss" in subsection 5907(1) of the Regulations is replaced by the following:

"loss", of a foreign affiliate of a taxpayer resident in Canada for a taxation year of the affiliate from an active business, means

(*a*) in the case of an active business carried on by it in a country, the amount of its loss for the year from the active business carried on in the country computed by applying the provisions of paragraph (*a*) of the definition "earnings" in this subsection respecting the computation of earnings from that active business carried on in that country, with any modifications that the circumstances require, and

(*b*) in any other case, the total of the amounts required by paragraph 95(2)(*a*) of the Act to be included in computing the affiliate's loss from an active business for the year;

(12) Subparagraph (*d*)(i) of the definition "net earnings" in subsection 5907(1) of the Regulations is replaced by the following:

> (i) shares of the capital stock of another foreign affiliate of the corporation that were excluded property of the affiliate (other than dispositions to which any of subsection 88(3) or paragraphs 95(2)(*c*), (*d*) or (*e*) of the Act applied), or

(13) Subparagraph (*b*)(v) of the definition "taxable earnings" in subsection 5907(1) of the Regulations is replaced by the following:

> (v) the affiliate's net earnings for the year from dispositions of shares of the capital stock of another foreign affiliate of the corporation that were excluded property of the affiliate (other than dispositions to which any of subsection 88(3) or paragraphs 95(2)(*c*), (*d*) or (*e*) of the Act applied) or dispositions of partnership interests that were excluded property of the affiliate,

(14) Paragraph (*b*) of the definition "taxable loss" in subsection 5907(1) of the Regulations is amended by striking out the word "or" at the end of subparagraph (iii), by adding the word "or" at the end of subparagraph (iv) and by adding the following after subparagraph (iv):

> (v) to the extent that they have not otherwise been included under subparagraph (i) or deducted in computing an amount under subparagraph (*b*)(i) of the definition "taxable earnings", the loss for the year as determined under paragraph (*b*) of the definition "loss" minus the portion of any income or profits tax refunded by the government of a country for the year that can reasonably be regarded as tax refunded in respect of that loss,

(15) Subparagraph 5907(1.1)(*b*)(ii) of the Regulations is replaced by the following:

> (ii) an amount is paid by the primary affiliate to a secondary affiliate in respect of a reduction or refund because of a loss or a tax credit of the secondary affiliate for a taxation year of the income or profits tax that would otherwise have been payable by the primary affiliate for the year on behalf of the consolidated group,
>
> (A) in respect of the primary affiliate,
>
> (I) the portion of the amount so paid that can reasonably be regarded as relating to an amount deducted from the

exempt surplus or included in the exempt deficit, as the case may be, of the secondary affiliate shall at the end of the year to which the loss or the tax credit relates be deducted from the exempt surplus or added to the exempt deficit, as the case may be, of the primary affiliate, and

(II) the portion of the amount so paid that can reasonably be regarded as relating to an amount deducted from the taxable surplus or included in the taxable deficit, as the case may be, of the secondary affiliate shall at the end of the year to which the loss or the tax credit relates be deducted from the taxable surplus or added to the taxable deficit, as the case may be, of the primary affiliate and be added to the underlying foreign tax of the primary affiliate, and

(B) in respect of the secondary affiliate, the amount is deemed to be a refund to the secondary affiliate for the year to which the loss or the tax credit relates of income or profits tax in respect of the loss or the tax credit.

(16) Paragraphs 5907(2.7)(*a*) and (*b*) of the Regulations are replaced by the following:

(*a*) an amount is included in computing the income or loss from an active business of a particular foreign affiliate of a taxpayer for a particular taxation year under paragraph 95(2)(*a*) of the Act, and

(*b*) the amount is in respect of an amount paid or payable (other than an amount paid or payable that is described in clause 95(2)(*a*)(ii)(D) of the Act) by another non-resident corporation described in paragraph 95(2)(*a*) of the Act or by a partnership of which such a corporation is a member,

(17) Subsection 5907(2.9) of the Regulations is replaced by the following:

(2.9) If paragraph 95(2)(*k*.1) of the Act applies in respect of a particular taxation year of a foreign affiliate of a taxpayer or in respect of a particular fiscal period of a partnership at the end of which a foreign affiliate of a taxpayer is a member of the partnership (which foreign affiliate or partnership is referred to in this subsection as the "operator" and which particular taxation year or particular fiscal period is referred to in this subsection as the "specified taxation year"), in computing the affiliate's earnings or loss from the foreign business referred to in that paragraph (which foreign business is referred to in this subsection as the "foreign business") for the affiliate's taxation year (which taxation year is referred to in paragraphs (*a*) and (*b*) as the "preceding taxation year") that is the affiliate's preceding taxation year referred to in paragraph 95(2)(*k*) of the Act or that is the affiliate's taxation year in which the preceding fiscal period referred to in paragraph 95(2)(*k*) of the Act ended, as the case may be,

(*a*) there shall be added to the amount determined under paragraph (*a*) of the definition "earnings" in subsection (1), after adjustment in accordance with subsections (2) to (2.2),

(i) where the operator is the affiliate, the total of

(A) the amount, if any, by which the total determined under subclause (*b*)(i)(A)(II) in respect of the operator for the preceding taxation year exceeds the total determined under subclause (*b*)(i)(A)(I) in respect of the operator for that year,

(B) if the operator was deemed because of paragraphs 95(2)(*k.1*) and 138(11.91)(*e*) of the Act to have, at the end of the preceding taxation year, disposed of property owned by it that was used or held by it in the course of carrying on the foreign business in that year, the total of all amounts each of which is the amount, if any, by which

(I) the lesser of the fair market value and the cost to the operator immediately before the end of that year of a capital property (referred to in this subclause and in subclause (II) as a "particular depreciable asset") owned by it that

1. was used or held by it in the course of carrying on the foreign business in that year,

2. was deemed because of paragraphs 95(2)(*k.1*) and 138(11.91)(*e*) of the Act to have been disposed of at the end of that year, and

3. was property in respect of the cost of which amounts were, at any time, deductible in computing the operator's income or loss for the purpose of computing the affiliate's earnings or loss from the foreign business under paragraph (*a*) of the definition "earnings", or under paragraph (*a*) of the definition "loss", in subsection (1)

exceeds

(II) the amount, if any, by which the cost to the operator immediately before the end of that year of the particular depreciable asset exceeds the total of all amounts each of which is an amount that can reasonably be regarded as having been deducted in respect of the cost of the particular depreciable asset in computing the operator's income or loss for the purpose of computing the earnings or loss (determined without reference to this subsection) of the affiliate from the foreign business in any taxation year preceding the specified taxation year of the affiliate in which it was a foreign affiliate of the corporation or of another corporation resident in Canada with which the corporation was not dealing at arm's length at any time, and

(C) if the operator was deemed because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act to have, at the end of the preceding taxation year, disposed of property owned by it that was used or held by it in the course of carrying on the foreign business in that year, the total of all amounts each of which is the amount, if any, by which the fair market value, immediately before the end of that year, of each property (other than capital property, eligible capital property or resource property) deemed because of those paragraphs to have been disposed of exceeds the cost to the operator of the property at that time,

(D) if the operator was deemed because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act to have, at the end of the preceding taxation year, disposed of eligible capital property, the amount, if any, required by subsection 14(1) of the Act to be included in computing the operator's income for that year from the foreign business, and

(E) if the operator was deemed because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act to have, at the end of the preceding taxation year, disposed of resource property, the amount, if any, by which

(I) the total of all amounts included by subsection 59(1) or paragraph 59(3.2)(*c*) or (*c*.1) of the Act in computing the operator's income for that year from the foreign business

exceeds

(II) the total of all amounts that were deductible under section 66, 66.1, 66.2, 66.21 or 66.4 of the Act in computing the operator's income for that year from the foreign business, and

(ii) where the operator is the partnership, the proportion of the total determined under subparagraph (i) that the affiliate's share of the partnership's income or loss for the preceding taxation year is of the partnership's income or loss for that year but, for the purpose of this subparagraph, if both the income and loss of the partnership for the preceding taxation year are nil, that proportion shall be determined as if the partnership had income for that year in the amount of $ 1,000,000, and

(*b*) there shall be added to the amount determined under paragraph (*a*) of the definition "loss" in subsection (1)

(i) where the operator is the affiliate, the total of

(A) the amount, if any, by which

(I) the total of all amounts each of which is an amount deemed because of paragraphs 95(2)(*k*.1) and 138(11.91)(*d*) of the Act to have been claimed under paragraph 20(1)(*l*), 20(1)(*l*.1) or 20(7)(*c*), or subparagraph 138(3)(*a*)(i), (ii) or (iv), of the Act (each of which provisions is referred to in this subparagraph as a "reserve provision") in computing the income from the foreign business for the preceding taxation year

exceeds

(II) the total of all amounts each of which is an amount actually claimed by the operator as a reserve in computing its income from the foreign business for that year that can reasonably be considered to be in respect of amounts in respect of which a reserve could have been claimed under a reserve provision on the assumption that the operator could have claimed amounts in respect of the reserve provisions for that year,

(B) the total of all amounts each of which is the amount, if any, by which the amount determined under subclause (*a*)(i)(B)(II) in respect of a particular depreciable asset described in subclause (*a*)(i)(B)(I) exceeds the fair market value, at the end of the preceding taxation year, of the particular depreciable asset,

(C) if the operator was deemed because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act to have, at the end of the preceding taxation year, disposed of property owned by it that was used or held by it in the course of carrying on the foreign business in that year, the total of all amounts each of which is the amount, if any, by which the cost to the operator, immediately before the end of that year, of each property (other than capital property, eligible capital property or resource property) deemed because of those paragraphs to have been disposed of exceeds the fair market value of the property at the end of that year,

(D) if the operator was, because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act, deemed to have, at the end of the preceding taxation year, disposed of eligible capital property, the amount, if any, that would be permitted by paragraph 24(1)(*a*) of the Act to be deducted in computing the operator's income for that year from the foreign business if the operator had, immediately before the end of that year, ceased to carry on the foreign business, and

(E) the amount, if any, by which the total determined in respect of the operator in subclause (*a*)(i)(E)(II) for the preceding taxation year exceeds the total determined in respect of the operator in subclause (*a*)(i)(E)(I) for that year, and

(ii) where the operator is the partnership, the proportion of the total determined under subparagraph (i) that the affiliate's share of the income or loss of the partnership for the preceding taxation year is of the income or loss of the partnership for that year but, for the purpose of this subparagraph, if both the income and loss of the partnership for the preceding taxation year are nil, that proportion is determined as if the partnership had income for that year in the amount of $1,000,000.

(2.91) Any property of a foreign affiliate of a corporation resident in Canada, or of a partnership of which a foreign affiliate of a corporation resident in Canada is a member, that is, for the purposes of subdivision i of Division B of Part I of the Act, deemed because of either paragraph 95(2)(*k*.1) or (*k*.3), and paragraph 138(11.91)(*e*), of the Act to have been disposed of and reacquired by the affiliate or the partnership, as the case may be, is, for the purpose of this section, deemed to have been disposed of and reacquired by the affiliate or the partnership, as the case may be, in the same manner and for the same amounts as if those provisions applied for the purpose of this section.

(18) Subsections 5907(5) and (5.1) of the Regulations are replaced by the following:

(5) Subject to subsection (5.1), for the purpose of this section

(*a*) the rules set out in subsection 95(2) of the Act apply in respect of the computation of each capital gain, capital loss, taxable capital gain, and allowable capital loss, of a foreign affiliate of a taxpayer from the disposition of property; and

(*b*) if any of those gains or losses is required to be computed in Canadian currency, the amount of the gain or loss is to be converted from Canadian currency into the currency referred to in subsection (6) at the rate of exchange prevailing on the date of disposition of the property.

(5.1) Subject to subsection (9), for the purpose of this section, the following rules apply in respect of a disposition to a transferee of an excluded property (as defined in subsection 95(1) of the Act) by a transferor that is either a foreign affiliate of a taxpayer resident in Canada or a partnership of which a foreign affiliate of a taxpayer resident in Canada is a member:

(*a*) the transferor's proceeds of disposition of the property is deemed to be an amount equal to the total of the cost amount to the transferor of the property immediately before the disposition and of any outlays and expenses to the extent they were made or incurred by the transferor for the purpose of making the disposition;

(*b*) the cost to the transferee of the property is deemed to be an amount equal to the transferor's proceeds of disposition of the property;

(*c*) the transferee is deemed to have acquired the property at the time the transferor acquired it;

(*d*) the cost to the transferor of a particular property (other than an interest in the transferee, or a property the cost of which is, because this subsection applies to the transferee in respect of the disposition of that property, determined under paragraph (*b*) and to which this subsection applies to the transferee in respect of the disposition of the property) that became receivable by the transferor as consideration for the disposition is deemed to be the fair market value of the particular property at the time of the disposition; and

(*e*) the cost to the transferor of each interest in the transferee that became receivable by the transferor as consideration for the disposition is deemed to be the amount, if any, determined by the formula

$$(A-B) \times C/D$$

where

A is the transferor's proceeds of disposition of the property,

B is the cost to the transferor of a property (other than an interest in the transferee, or a property the cost of which is, because this subsection applies to the transferee in respect of the disposition of that property, determined under paragraph (*b*) and to which this subsection applies to the transferee in respect of the disposition of the property) that was receivable by the transferor as consideration for the disposition,

C is the fair market value, immediately after the disposition, of that interest in the transferee, and

D is the fair market value, immediately after the disposition, of all interests in the transferee that were receivable by the transferor as consideration for the disposition.

(5.2) An interest in the transferee referred to in subsection (5.1) is

(*a*) if the transferee is a corporation, a share of the capital stock of the corporation;

(*b*) if the transferee is a partnership, an interest in the partnership; and

(*c*) if the transferee is a trust, a beneficial interest in the trust.

(5.3) Subsection (5.1) does not apply to a disposition of property if

(*a*) the gain or loss, if any, in respect of the disposition was included in computing an amount that was taxable under the income tax law, of a country other than Canada, that is relevant in computing the earnings of the affiliate from an active business carried on by it; or

(*b*) subsection 88(3), or paragraph 95(2)(*c*), (*d*) or (*e*), of the Act applied in respect of the disposition.

(19) The portion of subsection 5907(9) of the Regulations before paragraph (*a*) is replaced by the following:

(9) If a foreign affiliate of a taxpayer resident in Canada has been dissolved (otherwise than as a result of a foreign merger within the meaning assigned by subsection 87(8.1) of the Act) and paragraph

95(2)(*e*.1) of the Act does not apply, for the purpose of computing the various amounts referred to in this section

Application

General

5. (1) Section 1 applies to dispositions that occur after ANNOUNCEMENT DATE.

(2) Subsection 2(1) applies to amalgamations that occur, and to windings-up that begin, after ANNOUNCEMENT DATE.

(3) Subsections 2(2) and 3(1) apply to dissolutions that occur after ANNOUNCEMENT DATE.

(4) Subsections 3(2) to (14), (16) and (17) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after ANNOUNCEMENT DATE.

(5) Subsection 3(15) applies to payments made after ANNOUNCEMENT DATE.

(6) Subsection 3(18) applies to dispositions made after ANNOUNCEMENT DATE.

(7) Subsection 3(19) applies to dissolutions that begin after ANNOUNCEMENT DATE.

Elections – Early Application of Certain Provisions

6. If a taxpayer, a foreign affiliate of whom is referred to in subsections 3(2) to (10), (12) to (14) and (16), makes a valid election under subsection 39(39) of the legislative proposals related to the *Income Tax Act* released on ANNOUNCEMENT DATE, subsections 3(2) to (10), (12) to (14) and (16) apply to taxation years, of all foreign affiliates of the taxpayer, that begin after 1994, except that

> **(*a*) clause (*d*)(ii)(D) of the definition "exempt earnings" in subsection 5907(1) of the Regulations, as enacted by subsection 3(6), is, for the taxation years, of all foreign affiliates of the taxpayer, that end before 2000, to be read as follows:**
>
> > (D) if a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year is a member of a particular partnership (other than where the non-resident corporation

would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" of a partnership in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the non-resident corporation is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(*b*) clauses (*d*)(ii)(F) and (G) of the definition "exempt earnings" in subsection 5907(1) of the Regulations, as enacted by subsection 3(6), is, for the taxation years, of all foreign affiliates of the taxpayer, that end before 2000, to be read as follows:

(F) if another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year is a member of a particular partnership (other than where the other foreign affiliate would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" of a partnership in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the other foreign affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(G) if the particular affiliate is a member of a particular partnership (other than where the particular affiliate would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the income of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(C) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the particular affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(*c*) clause (*c*)(ii)(D) of the definition "exempt loss" in subsection 5907(1) of the Regulations, as enacted by subsection 3(9), is, for the taxation years, of all foreign affiliates of the taxpayer, that end before 2000, to be read as follows:

(D) if a non-resident corporation to which the particular affiliate and the particular corporation are related throughout the year is a member of a particular partnership (other than where the non-resident corporation would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" of a partnership in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(A) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the non-resident corporation is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,

(*d*) clauses (*c*)(ii)(F) and (G) of the definition "exempt loss" in subsection 5907(1) of the Regulations, as enacted by subsection 3(9), is, for the taxation years, of all foreign affiliates of the taxpayer, that end before 2000, to be read as follows:

> (F) if another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year is a member of a particular partnership (other than where the other foreign affiliate would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" of a partnership in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(B) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the other foreign affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt earnings or exempt loss for the year or for a subsequent taxation year,
>
> (G) if the particular affiliate is a member of a particular partnership (other than where the particular affiliate would be a specified member of the particular partnership at any time in a fiscal period of the particular partnership that ends in the year if the definition "specified member" of a partnership in subsection 248(1) of the Act were read without reference to paragraph (*a*) of that definition), amounts required to be included in computing the loss of the particular affiliate from an active business for the year because of clause 95(2)(*a*)(ii)(C) of the Act that are derived from amounts paid or payable, directly or indirectly, to it or to another partnership of which it is a member by the particular partnership, to the extent that, if the particular partnership were a foreign affiliate of a corporation and were resident in the country in which the particular affiliate is resident and subject to income taxation, the amounts paid or payable by the particular partnership would be deductible in computing its exempt

earnings or exempt loss for the year or for a subsequent taxation year,

7. If a taxpayer referred to in subsection 5907(2.9) of the Regulations, as enacted by subsection 3(17), makes a valid election under subsection 39(40) of the legislative proposals related to the *Income Tax Act* released on ANNOUNCEMENT DATE, subsections 5907(2.9) and (2.91) of the Regulations, as enacted by subsection 3(17), apply to taxation years, of all foreign affiliates of the taxpayer, that begin after 1994.

FOREIGN AFFILIATES

EXPLANATORY NOTES

ITR
Part LIX

Part LIX of the *Income Tax Regulations* provides rules for the provisions in the Act relating to foreign affiliates of a taxpayer.

Part LIX sets out, among other things, rules respecting the computation of the exempt surplus, taxable surplus and underlying foreign tax of a foreign affiliate in respect of a corporation resident in Canada. These surplus balances are used in determining a Canadian corporation's liability for income tax resulting from the payment of a dividend by a foreign affiliate or, in certain circumstances, from the realization of a capital gain on the disposition of a share of a foreign affiliate. Part LIX also sets out the calculation of a foreign affiliate's deductible loss for a taxation year and the calculation of the participating percentage of a share owned by a taxpayer of a corporation in respect of any controlled foreign affiliate of the taxpayer. Those calculations are used in determining the foreign accrual property income (FAPI) for the year of a controlled foreign affiliate of a taxpayer and the amounts to be included in a taxpayer's income in respect of the FAPI of that controlled foreign affiliate.

Election in Respect of Capital Gains

ITR
5902

Section 5902 of the Regulations applies where a corporation elects to treat proceeds of disposition of a share of a foreign affiliate as a dividend under subsection 93(1) of the Act.

ITR
5902(7)

Where, because of an election under subsection 93(1) of the Act, a dividend is deemed to have been received on shares of a foreign affiliate of a taxpayer, subsection 5902(1) of the Regulations computes the affiliate's surplus accounts and the amount of a dividend used in applying subsection 5901(1) for the purpose of subsection 5900(1) of the Regulations. A proposed amendment to subsection 5902(1), which was announced by the Department of Finance in Finance News Release 2001-029, dated March 16, 2001, would ensure that subsection 5902(1) will also apply where the corporation resident in Canada has elected under subsection 93(1.2) of the Act to treat a gain from a partnership arising on the disposition of a share of a foreign affiliate of the corporation by the partnership as a dividend.

Under proposed subsection 5902(7) of the Regulations, the determinations under subsection 5902(1) of the Regulations are modified to restrict the elected amount under subsection 93(1) or (1.2) of the Act to the net surplus of the particular affiliate where shares are being disposed of. Proposed subsection 5902(7) prevents the possible duplication of surplus amounts on sales of shares within a group of foreign affiliates or to non-arm's length corporations.

Proposed subsection 5902(7) applies to dispositions that occur after Announcement Date.

Special Rules

ITR
5905

Section 5905 of the Regulations provides special rules, for the purposes of determining surpluses and deficits and underlying foreign tax balances of a foreign affiliate in respect of a corporation resident in Canada, that apply where any of the specified types of transactions in respect of the foreign affiliate occurs.

ITR
5905(5) and (6)

Subsections 5905(5) and (6) of the Regulations apply where, as a result of specified types of transactions, all or any of the shares, of the capital stock of a particular foreign affiliate of a corporation resident in Canada, owned by a "predecessor corporation" are acquired by, or otherwise become the property of, an "acquiring corporation". These transactions are described in detail in paragraphs 5905(5)(*a*), (*b*) and (*c*) and can be generally described as follows:

- a transfer of shares of the capital stock of the particular affiliate by a corporation (the "predecessor corporation") resident in Canada to a taxable Canadian corporation (the "acquiring corporation") with which the predecessor corporation does not deal at arm's length;
- an amalgamation of two or more corporations (each corporation being referred to as a "predecessor corporation") to form a new corporation (the "acquiring corporation") if
  - section 87 of the Act applies to the amalgamation, and

  - as a result of the amalgamation, shares of the capital stock of the particular affiliate become the property of the acquiring corporation; or

- a winding-up of a corporation (the "predecessor corporation") into another corporation (the "acquiring corporation") if

  - subsection 88(1) of the Act applies to the winding-up, and

  - as a result of the winding-up, shares of the capital stock of the particular affiliate become the property of the acquiring corporation.

Subsections 5905(5) and (6) provide rules for computing the "opening exempt surplus", "opening exempt deficit", "opening taxable surplus", "opening taxable deficit" and "opening underlying foreign tax" of the particular affiliate (and of each other foreign affiliate of the predecessor corporation in which the particular affiliate has an equity percentage) in respect of the acquiring corporation. These rules ensure that the appropriate amounts of surplus, deficit and underlying foreign tax balances of the particular affiliate (and of the relevant subsidiaries of the particular affiliate) in respect of the predecessor corporation are assumed by the acquiring corporation as a result of the reorganization.

ITR
5905(5.1), (5.2), (5.3) and (5.4)

Proposed subsections 5905(5.1), (5.2), (5.3) and (5.4) of the Regulations supplement the rules in subsections 5905(5) and (6) in order to ensure that the opening surplus, deficit and underlying foreign tax balances of the particular affiliate in respect of the acquiring corporation as determined by subsection 5905(5) are adjusted to take into account

- in the case of an amalgamation that is described in paragraph 5905(5)(*b*) and to which subsection 87(11) of the Act applies, the total amounts of step-ups (as determined by paragraph 88(1)(*d*) of the Act in applying subsection 87(11) of the Act) to the adjusted cost base of the shares of the capital stock of the particular affiliate which became the property of the acquiring corporation as a result of the amalgamation, and

- in the case of a winding-up that is described in paragraph 5905(5)(*c*), the total amount of step-ups (as determined by paragraph 88(1)(*d*) of the Act) to the adjusted cost base of the shares of the capital stock of the particular affiliate which became the property of the acquiring corporation as a result of the winding-up.

New subsection 5905(5.1) provides that, in the case of an amalgamation specified in the subsection, or in the case of a winding-up specified in the subsection, the particular affiliate's opening exempt surplus in respect of the acquiring corporation as determined under paragraph 5905(5)(*d*) is to be decreased by the amount (referred to in this commentary as "R") that is equal to the lesser of

- the total (referred to in this commentary as "T") of all amounts, each of which is the amount, if any,
  - determined under paragraph 88(1)(*d*) of the Act in applying subsection 87(11) of the Act in respect of the shares of the capital stock of the particular affiliate which, as a result of that amalgamation, become the property of the acquiring corporation, or
  - determined under paragraph 88(1)(*d*) of the Act in respect of the shares of the capital stock of the particular affiliate which, as a result of that winding-up, become the property of the acquiring corporation, and
- the particular affiliate's opening exempt surplus in respect of the predecessor corporation as otherwise determined under paragraph 5905(5)(*d*).

New subsection 5905(5.2) provides that, in the case of an amalgamation specified in the subsection or in the case of a winding-up specified in the subsection, the particular affiliate's opening taxable surplus in respect of the acquiring corporation as determined under paragraph 5905(5)(*f*) is to be decreased by the amount (referred to in this commentary as "S") that is equal to the least of

- the amount determined by the formula

  $$(T - R)$$

  where T and R are referred to in the commentary to new subsection 5905(5.1) above,
- the particular affiliate's taxable surplus in respect of the predecessor corporation as otherwise determined under paragraph 5905(5)(*f*), and
- the amount determined by the formula

$$A \times B$$

where

A is the amount that would be the particular affiliate's underlying foreign tax in respect of the acquiring corporation determined under paragraph 5905(5)(*h*) if the Regulations were read without reference to subsection 5905(5.4), and

B is the relevant tax factor (as defined in subsection 95(1) of the Act) of the acquiring corporation.

New subsection 5905(5.3) provides that, in the case of a an amalgamation, specified in the subsection or in the case of a winding-up, specified in the subsection, the particular affiliate's opening exempt deficit in respect of the acquiring corporation as determined under paragraph 5905(5)(*e*) is to be increased by the amount equal to the amount determined by the formula

$$T - (R + S),$$

where R, S and T are described in the commentary to new subsections 5905(5.1) and (5.2) above.

New subsection 5905(5.4) provides that, in the case of an amalgamation described in the subsection, or in the case of a winding-up described in the subsection, the particular affiliate's opening underlying foreign tax in respect of the acquiring corporation as determined under paragraph 5905(5)(*h*) is to be decreased by the amount, if any, determined by the formula

$$A / B$$

where

A is the amount of the decrease determined under subsection 5905(5.2), and

B is the relevant tax factor (as defined in subsection 95(1) of the Act) of the acquiring corporation for the taxation year of the acquiring corporation that

- in the case of an amalgamation, ended immediately before the amalgamation, and
- in the case of a winding-up, included the time the winding-up began.

New subsections 5905(5.1) to (5.4) apply to amalgamations that occur, and windings-up that begin, after Announcement Date.

ITR
5905(7) to (7.4)

Subsection 5905(7) of the Regulations applies where a foreign affiliate (the "disposing affiliate") of a corporation resident in Canada dissolves in circumstances where paragraph 95(2)(*e*.1) of the Act applies in respect of the dissolution.

Paragraph 95(2)(*e*.1) of the Act provides for the rollover of capital property, of a foreign affiliate (the "disposing affiliate") of a taxpayer, to another foreign affiliate of the taxpayer on a liquidation and a dissolution of the disposing affiliate where certain conditions have been met. One of the conditions is that, immediately before the liquidation, the taxpayer's surplus entitlement percentage in respect of the disposing affiliate was not less than 90%. Another is that the liquidation is not taxable in the country where the disposing affiliate resides.

Subsection 5905(7) provides that each other foreign affiliate of the corporation resident in Canada that has a direct equity percentage in the disposing affiliate immediately before the time of the dissolution is, for the purposes of computing its exempt surplus, taxable surplus, exempt deficit, taxable deficit and underlying foreign tax balances in respect of the corporation, deemed to have received, immediately before that time, dividends from the disposing affiliate of the amount that that other affiliate could reasonably be expected to have received if the disposing affiliate had paid dividends equal to the amount of its net surplus in respect of the corporation immediately before that time.

Subsection 5905(7) is proposed to be amended in the following ways.

First, the conditions under which subsection 5905(7) applies are proposed to be amended to refer to a "liquidation and a dissolution" to better track the language in paragraph 95(2)(*e*.1) of the Act.

Second, the subsection is proposed to be amended so that the dividend deemed by that subsection to have been received is considered to have been received immediately before the "specified time". The expression "specified time" is defined in new subsection 5905(7.1) to mean the time that is the earlier of

- the time at which the disposing affiliate was dissolved, and
- the time of the earliest distribution of property as part of the liquidation and the dissolution of the disposing affiliate.

Third, the subsection is proposed to be amended to deal with the case where the disposing affiliate has an exempt deficit or taxable deficit in respect of the corporation immediately before the specified time. These amendments ensure that

- the dividend deemed by the subsection to have been received immediately before the specified time is equal to the sum of the disposing affiliate's exempt surplus (if any) and the disposing affiliate's taxable surplus (if any) in respect of the corporation immediately before that time,

- the exempt deficit in respect of the corporation of each other foreign affiliate of the corporation that held a direct equity percentage in the disposing affiliate is, immediately before the specified time, increased by that other affiliate's proportionate share of the disposing affiliate's exempt deficit in respect of the corporation,

- the taxable deficit in respect of the corporation of each other foreign affiliate of the corporation that held a direct equity percentage in the disposing affiliate is, immediately before the specified time, increased by that other affiliate's proportionate share of the disposing affiliate's taxable deficit in respect of the corporation,

- the exempt surplus in respect of the corporation of each other foreign affiliate of the corporation that held a direct equity percentage in the disposing affiliate is, immediately before the specified time, decreased by that other affiliate's proportionate share of the disposing affiliate's exempt deficit in respect of the corporation, and

- the taxable surplus in respect of the corporation of each other foreign affiliate of the corporation that held a direct equity percentage in the disposing affiliate is, immediately before the specified time, decreased by that other affiliate's proportionate share of the disposing affiliate's taxable deficit in respect of the corporation.

Section 5905 is proposed to be amended to introduce new subsections 5905(7.1) to (7.4).

New subsection 5905(7.1) provides, for the purpose of subsection 5905(5), a definition of the expression "specified time". For more detail, see the commentary to subsection 5905(7).

New subsections 5905(7.2) to (7.4) provide for the following rules in relation to section 5905(7):

- the exempt surplus, exempt deficit, taxable surplus, taxable deficit and underlying foreign tax of the disposing affiliate in respect of the corporation at any time is to be determined on the assumption that the taxation year of the disposing affiliate that would otherwise have included that time had ended immediately before that time (subsection 5905(7.2));

- an affiliate's proportionate share of the exempt deficit, if any, of the disposing affiliate in respect of the corporation at any time is equal to the amount it could reasonably have expected to receive if the disposing affiliate had, immediately before that time, paid a dividend equal to the amount of its exempt deficit, if any, in respect of the corporation (subsection 5905(7.3));

- an affiliate's proportionate share of the taxable deficit, if any, of the disposing affiliate in respect of the corporation at any time is equal to the amount it could reasonably have expected to receive if the disposing affiliate had, immediately before that time, paid a dividend equal to the amount of its taxable deficit, if any, in respect of the corporation (subsection 5905(7.4).

Amended subsection 5905(7) and new subsections 5905(7.1) to (7.4) ensure that the exempt deficit and the taxable deficit of the disposing affiliate of a group of affiliates in respect of a taxpayer are absorbed by the other affiliates in the group.

Amended new subsection 5907(7) and new subsections 5905(7.1) to (7.4) are proposed to apply to dissolutions that occur after Announcement Date.

Interpretation

ITR
5907

Section 5907 of the Regulations provides definitions and interpretation rules for the purposes of Part LIX of the Regulations.

ITR
5907(1)

Subsection 5907(1) of the Regulations provides definitions for the purposes of Part LIX of the Regulations.

“earnings”

The definition “earnings” of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the affiliate.Paragraph (*b*) of the definition “earnings” in subsection 5907(1) of the Regulations ensures that “earnings” will reflect the total of all amounts by which the affiliate’s income for the year from an active business is increased because of paragraph 95(2)(*a*) of the Act.

Consequential to the amendments made to paragraph 95(2)(*a*) of the Act to provide for amounts by which such income of the affiliate could be decreased, paragraph (*b*) of the definition “earnings” in subsection 5907(1) of the Regulations is proposed to be amended to ensure that “earnings” will reflect the total of all amounts required by paragraph 95(2)(*a*) to be included (either as a plus or as a minus) in computing the affiliate’s income for the year from an active business. For more detail, refer to the commentary to paragraph 95(2)(*a*). The amendment to paragraph (*b*) of the definition “earnings” in subsection 5907(1) applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

“exempt earnings”

The definition “exempt earnings”, of a foreign affiliate of a particular corporation for a taxation year, in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the affiliate.

The definition contains a number of provisions. Subparagraphs (*d*)(i) and (ii) of the definition “exempt earnings” are relevant to the understanding of the commentary below. Those particular provisions provide as follows:

- Subparagraphs (*d*)(i) and (ii) of the definition “exempt earnings” provide that, where a foreign affiliate of a particular corporation is resident in a designated treaty country, the affiliate’s earnings for the year from an active business carried on by it in a designated treaty country and the amounts included in its income from an active business for the year under paragraph 95(2)(*a*) of the Act, respectively, are included in computing its “exempt earnings” for the year.

- Clause (*d*)(ii)(D) of the definition "exempt earnings" includes, in the exempt earnings of a foreign affiliate of a particular corporation, income derived from amounts paid or payable to the affiliate by a partnership of which a non-resident corporation to which the affiliate and the particular corporation are related throughout the year was a member (other than a "specified member" at any time in a fiscal period of a partnership that ends in the year) if that income is deemed by clause 95(2)(*a*)(ii)(A) of the Act to be income from an active business of the affiliate. This will be the case to the extent that the amounts paid or payable would be deductible in computing the exempt earnings or the exempt loss of the partnership if it were a foreign affiliate of a corporation.

- Clause (*d*)(ii)(F) of the definition "exempt earnings" includes, in the exempt earnings of a foreign affiliate of a particular corporation, income derived from amounts paid or payable to the affiliate by a partnership of which another foreign affiliate of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year was a member (other than a "specified member" at any time in a fiscal period of a partnership that ends in the year) if that income is deemed by clause 95(2)(*a*)(ii)(B) of the Act to be income from an active business of the affiliate. This will be the case to the extent that the amounts paid or payable would be deductible in computing the exempt earnings or the exempt loss of the partnership if it were a foreign affiliate of a corporation.

- Clause (*d*)(ii)(G) of the definition "exempt earnings" includes, in the exempt earnings of a foreign affiliate of a corporation, income derived from amounts paid or payable to the affiliate by a partnership of which the affiliate was a member (other than a specified member at any time in a fiscal period of a partnership that ends in the year) if that income is deemed by clause 95(2)(*a*)(ii)(C) of the Act to be income from an active business of the affiliate. This will be the case to the extent that the amounts paid or payable would be deductible in computing the exempt earnings or the exempt loss of the partnership if it were a foreign affiliate of a corporation.

- Clause (*d*)(ii)(H) of the definition "exempt earnings" includes, in the exempt earnings of a foreign affiliate of a particular corporation, income derived from amounts paid or payable to it (or to a partnership of which it is a member) by another foreign affiliate (the "second affiliate") of the particular corporation related to it and to the particular corporation throughout the year if that income is deemed by clause 95(2)(*a*)(ii)(D) of the Act to be the income from an active business of the affiliate. The income must be derived from amounts paid or payable in respect of interest on

> borrowed money used to earn income from property or on an amount payable for property. That property must consist of shares of another foreign affiliate (the "third affiliate") of the particular corporation in respect of which the particular corporation has a qualifying interest throughout the year that are excluded property of the second affiliate. The second affiliate, the third affiliate and "each other affiliate relevant for the purpose of determining whether the shares of the third affiliate are excluded property" must all be resident in, and subject to income taxation in, the same designated treaty country. (The expression "designated treaty country" is defined in subsection 5907(11).) As well, the amounts paid or payable must be relevant in determining the liability for income taxes in the designated treaty country of a group of corporations composed of the second affiliate and one or more other foreign affiliates (the shares of which are excluded property), of the particular corporation, resident in that country and in respect of which the particular corporation has a qualifying interest throughout the year. For the purposes of making these determinations, two assumptions are made. First, the definition "excluded property" in subsection 95(1) of the Act is to be read without reference to amounts receivable referred to in paragraph (*c*) of that definition where, if interest were payable on the amounts, the interest would not be deductible by the debtor in calculating its exempt earnings or loss. Second, shares of a foreign affiliate (a "non-qualifying affiliate") that is non-resident and subject to income taxation in a designated treaty country are to be ignored in determining whether the shares of the third affiliate are excluded property, unless the shares of the third affiliate would not be excluded property if all shares of all non-qualifying affiliates were not excluded property. For convenience of reference, this second assumption is referred to in the remainder of this commentary to the definition "exempt earnings" as the "Shares Assumption".

As noted in the commentary to new clauses 95(2)(*a*)(ii)(A), (B) and (C) of the Act, those clauses are amended so that the condition requiring the partnership to have a relevant person as a member of the partnership (otherwise than as a specified member of the partnership) is replaced by a requirement that the relevant person to be a "qualifying member" of the partnership throughout each period, in the fiscal period of the partnership, that ends in the year. The expression "qualifying member" is newly defined in subsection 248(1) of the Act as being a person that would at the relevant time be determined to be a qualifying member of the partnership under paragraph 95(2)(*o*) of the Act. For more detail, see the commentary to paragraph 95(2)(*o*) and subsection 248(1) of the Act.

The amendments to clauses 95(2)(*a*)(ii)(A), (B) and (C) of the Act, in conjunction with the new definition "qualifying member", ensure that, in applying those clauses, limited partners and limited partnerships are treated in the same manner as general partners and general partnerships. These amendments also ensure that, even if the activities of the relevant person do not meet the business activity requirements in new subparagraph 95(2)(*o*)(i), a partnership may qualify under clauses 95(2)(*a*)(ii)(A), (B) or (C) if the relevant person has an equity interest in the partnership that meets the criteria set out in new subparagraph 95(2)(*o*)(ii). For more detail, see the commentary to new paragraph 95(2)(*o*) of the Act.

The definition "exempt earnings" is proposed to be amended in the following ways.

First, new paragraph (*a*.1) is added to the definition "exempt earnings" in subsection 5907(1) of the Regulations to include the untaxed portion of the gain from the sale of excluded property that is eligible capital property.

Second, subparagraph (*d*)(ii) of the definition "exempt earnings" in subsection 5907(1) is amended in the following ways:

- Consequential to the amendments made to paragraph 95(2)(*a*) of the Act, subparagraph (*d*)(ii) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is amended to provide that, in computing the affiliate's "exempt earnings" for the year, there will be included the earnings derived from "amounts required to be included in computing" income from an active business under amended paragraph 95(2)(*a*) of the Act.

- Clauses (*d*)(ii)(D), (F) and (G) of the definition "exempt surplus" in subsection 5907(1) of the Regulations are proposed to be amended consistent with similar amendments made to clauses 95(2)(*a*)(ii)(A), (B) and (C) of the Act. Accordingly, amendments (referred to in this commentary as the "Qualifying Member Amendments") are made to clauses (*d*)(ii)(D), (F) and (G) of the definition "exempt surplus" in subsection 5907(1) of the Regulations so that the condition requiring the partnership to have a relevant person as a member of the partnership (otherwise than as a specified member of the partnership) is replaced by a requirement that the relevant person be a "qualifying member" of the partnership throughout each period, in the fiscal period of the partnership, that ends in the year. The expression "qualifying member" is newly defined in subsection 248(1) of the Act as being a person that would at the relevant time be determined to be a qualifying member of the partnership under paragraph 95(2)(*o*) of the Act. For more detail, see the commentary to paragraph 95(2)(*o*) and (*q*) and subsection 248(1) of the Act.

- Consistent with the amendments to clause 95(2)(*a*)(ii)(D) of the Act, clause (*d*)(ii)(H) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is proposed to be amended to modify the requirement that the second affiliate, the third affiliate and "each other affiliate relevant for the purpose of determining whether the shares of the third affiliate are excluded property" must each be resident in, and subject to income taxation in, the same designated treaty country (sub-subclause (*d*)(ii)(H)(I)2.of the definition). That requirement is replaced with a requirement that

  - the second affiliate and the third affiliate must be resident in the same designated treaty country for each of their taxation years (each of which taxation years is referred to as a "relevant taxation year" of the second affiliate or of the third affiliate, as the case may be) that end in the year, and

  - in respect of each of the second affiliate and the third affiliate for each relevant taxation year of that affiliate, either that affiliate must be subject to income taxation in that country in that relevant taxation year, or, alternatively, the members or shareholders of that affiliate at the end of that relevant taxation year must be subject to income taxation in that country on, in aggregate, all or substantially all of the income of that affiliate for that relevant taxation year in their taxation years in which that relevant taxation year ends, or would be so subject to income taxation in that country if that affiliate had income for that relevant taxation year and the income of those members or shareholders for their taxation years in which that relevant taxation year ends consisted only of their share of income of that affiliate for that relevant taxation year.

- Further, clause (*d*)(ii)(H) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is proposed to be amended to delete the Shares Assumption. The Shares Assumption is no longer relevant as that clause no longer contains a reference to "each other affiliate relevant for the purpose of determining whether the shares of the third affiliate are excluded property".

- Clause (*d*)(ii)(H) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is also proposed to be amended to modify the requirement that the amounts paid or payable must be relevant in determining the liability for income taxes, in the designated treaty country in which the second and third affiliates are resident, of a group of corporations composed of the second affiliate, and one or more other foreign affiliates (the shares of which are excluded property), of the particular corporation, resident in that country and in respect of which the particular corporation has a qualifying interest throughout the year (subclause (*d*)(ii)(H)(II) of the definition). That requirement is to be replaced with a requirement that the amounts paid or payable must be relevant in computing the income for income tax purposes, in the designated treaty country in which the second affiliate and the third affiliate are resident,

- of the members (each of which members is referred to as a "group member") of a group of corporations, if the group is composed of the second affiliate and of one or more other foreign affiliates of the taxpayer (each of which other foreign affiliates is referred to as a "group affiliate"), the taxpayer has a qualifying interest in respect of each group affiliate throughout the year, the second affiliate and each group affiliate would (if the reference in sub-subclause (*d*)(ii)(H)(I)2. to "third affiliate" were read as a reference to "group affiliate") meet the requirements of those subclauses in the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of a group member, from a source in a particular place, for a taxation year of that group member that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country, or

- of the second affiliate, if the third affiliate meets the requirements of new sub-subclause 95(2)(*a*)(ii)(D)(V)2. of the Act in each relevant taxation year of the third affiliate, the taxpayer has a qualifying interest in respect of the third affiliate throughout the year and it is reasonable to conclude that all or substantially all of the amount that is the total of all amounts each of which is the income, or the absolute value of the loss, of the third affiliate, from a source in a particular place, for a taxation year of the third affiliate that ends in the year is attributable to incomes and losses from an active business carried on in a designated treaty country.

- Consequential to the introduction of new subparagraphs 95(2)(*a*)(v) and (vi) of the Act, new clause (*d*)(ii)(L) of the definition "exempt earnings" in subsection 5907(1) of the Regulations is proposed to be added. New clause (*d*)(ii)(L) ensures that income of a foreign affiliate, of a corporation, for a year that, because of new subparagraph 95(2)(*a*)(v) or (vi) of the Act, is included in computing the affiliate's active business income for the year, is included in computing the "exempt earnings" of the affiliate. For more detail, see the commentary to subsection 95(2) of the Act.

The amendments to paragraph (*a*.1), and subparagraph (*d*)(ii), of the definition "exempt earnings" in subsection 5907(1) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Global Section 95 Election package described in the beginning of the commentary to section 95 of the Act and that, in the event of a Global Section 95 Election, the Qualifying Member Amendments apply to taxation years, of a foreign affiliate of a taxpayer, that end after 1999.

"exempt loss"

The definition "exempt loss" of a foreign affiliate of a corporation for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the affiliate.

The definition "exempt loss" in subsection 5907(1) is proposed to be amended in the following ways.

First, consequential to the amendments proposed to be made to paragraph (*c*) of that definition, the "preamble" of that definition is proposed to be amended to refer to the foreign affiliate as the "particular" foreign affiliate.

Second, new paragraph (*a*.1) is proposed to be added to the definition "exempt loss" in subsection 5907(1) to include the non-taxable portion of a loss from the sale of excluded property that is eligible capital property.

Third, amendments are proposed to be made to paragraph (*c*) of the definition "exempt loss" in subsection 5907(1). Under existing paragraph (*c*) of the definition, where a particular foreign affiliate of a particular corporation is resident in a designated treaty country, the affiliate's losses for a year from an active business carried on by it in Canada or in a designated treaty country are included in computing its "exempt loss" for the year. Consequential to the amendments made to paragraph 95(2)(*a*) of the Act, paragraph (*c*) of the definition is proposed to be amended to ensure that losses from sources in a country, other than Canada, that would otherwise be property losses and are re-characterized by paragraph 95(2)(*a*) of the Act to be losses from an active business, are included in computing the "exempt loss" of the affiliate. The provisions to deal with these re-characterized losses are set out in new subparagraph (*c*)(ii) of the definition "exempt loss" and are modelled after the analogous provisions in proposed amended subparagraph (*d*)(ii) of the definition "exempt income" in subsection 5907(1) of the Regulations.

Fourth, a "postamble" to the definition "exempt loss" in subsection 5907(1) is proposed to be added to ensure that the amount that would otherwise be the "exempt loss" of a foreign affiliate of a particular corporation is reduced by the portion of any income or profits tax refunded by the government of a country for the year to the affiliate that can reasonably be regarded as tax refunded in respect of losses referred to in new subparagraph (*c*)(ii) of the definition "exempt loss" in subsection 5907(1).

The amendments to the definition "exempt loss" in subsection 5907(1) apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act, and that, in the event of a Global Section 95 Election, in its application to taxation years, of a foreign affiliate of a taxpayer, that end before 2000, the Member Criteria Condition will, instead of containing the Qualifying Member Requirement, contain the requirement that the partnership have a relevant person as a member of the partnership (otherwise than as a specified member of the partnership).

The expression "specified member" is defined in existing subsection 248(1) of the Act. For more detail, see the commentary to the definition "exempt earnings" in subsection 5907(1) of the Regulations.

"exempt surplus"

The definition "exempt surplus" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the affiliate.

The Regulations are proposed to be amended by replacing, with any grammatical changes that the circumstances require, every reference to "subsection 5905(7) " with a reference to "subsections 5905(7) and (7.1)" in the following subparagraphs of the description of A in the following definitions in subsection 5907(1) of the Regulations:

- subparagraph (iii) of the description of A in the definition "exempt surplus";
- subparagraph (iii) of the description of A in the definition "taxable surplus"; and
- subparagraph (iv) of the description of A in the definition "underlying foreign tax".

This amendment to the Regulations is to be effected by way of a global provision in the amending Regulation rather than by having the amending Regulation amend, provision by provision, each specific provision in the Regulations where a reference to subsection 5905(7) appears. This amendment to the Regulations is consequential to the division of subsection 5905(7) of the Regulations into subsections 5905(7) and (7.1). For more detail, refer to the commentary to subsections 5905(7) and (7.1).

This amendment to the Regulations is proposed to apply to dissolutions that occur after Announcement Date.

"loss"

The definition "loss" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the foreign affiliate.

Consequential to the amendments to paragraph 95(2)(*a*) of the Act, the definition "loss" in subsection 5907(1) of the Regulations is proposed to be amended to add new paragraph (*b*) to ensure that losses from sources in a country other than Canada, that would otherwise be property losses but are re-characterized by paragraph 95(2)(*a*) of the Act to be losses from an active business, are included in computing the "loss" of the affiliate.

The amendment to the definition "loss" in subsection 5907(1) is proposed to apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date.

"net earnings"

The definition "net earnings" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the foreign affiliate.

The proposed amendment to subparagraph (*d*)(i) of the definition "net earnings" in subsection 5907(1) of the Regulations is consequential to the amendments to the definition "foreign accrual property income" in subsection 95(1) of the Act. Those amendments to the definition "foreign accrual property income" ensure that capital gains and losses from dispositions of "excluded property" to which subsection 88(3) of the Act applies are included in computing foreign accrual property income. This amendment to the definition "net earnings" ensures that, in computing net earnings, those capital gains are not double-counted.

The proposed amendment to the definition "net earnings" in subsection 5907(1) of the Regulations applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

"taxable earnings"

The definition "taxable earnings" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses of the foreign affiliate.

The proposed amendment to subparagraph (*b*)(v) of the definition "taxable earnings" in subsection 5907(1) of the Regulations is consequential to the amendments to the definition "foreign accrual property income" in subsection 95(1) of the Act. The amendments to the definition "foreign accrual property income" ensure that capital gains and losses from dispositions of "excluded property" to which subsection 88(3) of the Act applies are included in computing foreign accrual property income. This amendment to the definition "taxable earnings" ensures that, in computing taxable earnings, those capital gains are not double-counted.

This amendment to the definition "taxable earnings" in subsection 5907(1) of the Regulations applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

"taxable loss"

The definition "taxable loss" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the foreign affiliate.

As noted in the commentary to the proposed amendments to the definition "loss" in subsection 5907(1), a property loss re-characterized by paragraph 95(2)(*a*) of the Act as loss from an active business is described in new paragraph (*b*) of the definition "loss" and is included in computing "loss".

The definition "taxable loss" in subsection 5907(1) of the Regulations is proposed to be amended by adding new subparagraph (*b*)(v). That subparagraph ensures that, to the extent that the loss for the year determined under paragraph (*b*) of the definition "loss" has not been included under existing subparagraph (*b*)(i) of the definition "taxable loss" or deducted in computing an amount under existing subparagraph (*b*)(i) of the definition "taxable earnings", that loss (minus the portion of any income or profits tax refunded by the government of a country for the year that can reasonably be regarded as tax refunded in respect of that loss in computing "loss" for the year) is to be included in computing "taxable loss" for the year. Note, also, that the existing "postamble" to the definition "taxable loss" ensures that "taxable loss" does not include any amount included in the affiliate's "exempt loss" for the year.

This proposed amendment to the definition "taxable loss" in subsection 5907(1) of the Regulations applies to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

"taxable surplus"

The definition "taxable surplus" of a foreign affiliate of a taxpayer resident in Canada for a taxation year in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the foreign affiliate.

For detail about the amendment to the definition "taxable surplus", refer to the commentary to the definition "exempt surplus".

"underlying foreign tax"

The definition "underlying foreign tax" of a foreign affiliate of a corporation resident in Canada, in respect of a corporation, in subsection 5907(1) of the Regulations is relevant for the purposes of computing the surpluses and deficits of the foreign affiliate.

For detail about the amendment to the definition "underlying foreign tax", refer to the commentary to the definition "exempt surplus" in subsection 5907(1).

ITR
5907(1.1)

Subsection 5907(1.1) of the Regulations contains rules for the calculation of the surpluses and deficits of a foreign affiliate of a corporation resident in Canada where the affiliate is a member of a group (the "consolidated group") of foreign affiliates of the corporation that files a consolidated or combined return in a foreign country such as the United States and one of the affiliates (the "primary affiliate") in the group is responsible, on behalf of the group, for paying, or claiming a refund of, the tax payable in that country by the primary affiliate and the other members of the group (those other members being referred to as the "secondary affiliates").

Subparagraph 5907(1.1)(*b*)(ii) applies where a secondary affiliate has a loss and the primary affiliate pays an amount to a secondary affiliate in respect of a reduction or refund, by virtue of the loss of the secondary affiliate, of the tax that would otherwise have been payable in the country by the primary affiliate for the year on behalf of the consolidated group. In general terms, that subparagraph results in a reduction of the primary affiliate's surplus balances, and an increase of the secondary affiliate's surplus balances, by the amount of the payment.

The proposed amendments to subparagraph 5907(1.1)(*b*)(ii) amend paragraph 5907(1.1)(*b*) to deal also with the case where a secondary affiliate has a tax credit and the primary affiliate pays an amount to the secondary affiliate in respect of a reduction or refund, by virtue of the tax credit of the secondary affiliate, of the tax that would otherwise have been payable in the country by the primary affiliate for the year on behalf of the consolidated group. In general terms, the amendments ensure that the primary affiliate's surplus balances are reduced, and the secondary affiliate's surplus balances are increased, by the amount of the payment.

The amendments to subparagraph 5907(1.1)(*b*)(ii) are proposed to apply to payments made after Announcement Date.

ITR
5907(2.7)

In general terms, subsection 5907(2.7) of the Regulations provides that, where amounts are included by subparagraph 95(2)(*a*)(i) or (ii) of the Act in computing the income or loss from an active business of a particular foreign affiliate of a taxpayer and these amounts are in respect of amounts paid or payable to the particular affiliate by another non-resident corporation or partnership in the group, the amounts paid or payable to the particular affiliate by the other non-resident corporation or partnership are required to be deducted in computing the other non-resident corporation's or partnership's earnings or loss from an active business (unless they have already been deducted under paragraph 5907(2)(*j*) of the Regulations) for the earliest taxation year in which the amounts were paid or payable.

Paragraphs 5907(2.7)(*a*) and (*b*) of the Regulations are proposed to be amended so that subsection 5907(2.7) applies to amounts included in computing the income or loss from an active business of the particular affiliate under paragraph 95(2)(*a*) of the Act, rather than just under subparagraph 95(2)(*a*)(i) or (ii).

The proposed amendments to subsection 5907(2.7) of the Regulations apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Global Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

ITR
5907(2.9)

Subsection 5907(2.9) of the Regulations applies where the fresh start rules in paragraph 95(2)(*k*) of the Act apply to a foreign affiliate of a corporation resident in Canada in respect of a "foreign business". Subsection 5907(2.9) ensures that appropriate adjustments are made to the surplus accounts of the affiliate.

In general terms, subsection 5907(2.9) provides that there is to be added to the affiliate's "earnings" (as defined in subsection 5907(1) of the Regulations), for the last taxation year of the affiliate before the fresh start year, the total of the following amounts:

- the amount by which the actual reserves claimed exceed the maximum reserve allowed under paragraph 95(2)(*k*) of the Act for that last taxation year;

- where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of depreciable property that was used or held by the affiliate in the course of carrying on the foreign business, the amount by which the lesser of the fair market value and the cost to the affiliate of the property exceeds the undepreciated capital cost (or an analogous concept under the relevant foreign tax law) of the property at the end of that last taxation year; and

- where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of property (other than capital property) that was used or held by the affiliate in the course of carrying on the foreign business, the amount by which the fair market value of the property exceeds the cost of the property to the affiliate at the end of that last taxation year.

These additions to "earnings" result in corresponding increases in the balance of the affiliate's relevant surplus account.

In general terms, subsection 5907(2.9) provides that there is to be deducted from "earnings" for the last taxation year of the affiliate before the fresh start year the total of the following amounts:

- the maximum reserve allowed under paragraph 95(2)(*k*) of the Act minus the actual reserve claimed at the end of that last taxation year;
- where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of depreciable property that was used or held by the affiliate in the course of carrying on the foreign business, the amount by which the undepreciated capital cost of the property exceeds the lesser of fair market value and cost to the affiliate of the property at the end of that last taxation year; and
- where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of property (other than capital property) that was used or held by the affiliate in the course of carrying on the foreign business, the amount by which the cost of the property to the affiliate exceeds the fair market value of the property at the end of that last taxation year.

These decreases to "earnings" result in corresponding decreases in the balance of the affiliate's relevant surplus account.

Subsection 5907(2.9) of the Regulations is proposed to be amended to reflect the amendments to the Act which are set out in amended paragraph 95(2)(*k*), new paragraph 95(2)(*k*.1) and amended subsection 138(11.91) of the Act. In particular, subsection 5907(2.9) is proposed to be amended in the following ways.

First, subsection 5907(2.9) of the Regulations is proposed to be amended to reflect the proposed splitting of paragraph 95(2)(*k*) of the Act into paragraphs 95(2)(*k*) and (*k*.1).

Second, consistent with paragraphs 95(2)(*k*) and (*k*.1) of the Act, the proposed amendments to subsection 5907(2.9) of the Regulations ensure that the fresh start rules will apply where the foreign business is carried on by a partnership of which a foreign affiliate of a taxpayer is a member. These amendments to subsection 5907(2.9) ensure, in the case of partnerships, that the fresh start rules will work on the basis of fiscal periods of the partnership and that these rules will therefore be relevant in the computation of the affiliate's foreign accrual property income for the affiliate's taxation year that includes the end of a fiscal period to which the fresh start rules apply. The expression "operator" refers to the affiliate (in the case where the affiliate directly carries on the foreign business) or to the partnership (in the case where the partnership carries on the foreign business). The amounts added by subsection 5907(2.9) to "earnings" or "loss" are used in computing the earnings or loss from the foreign business (when it was an active business) of the affiliate in the preceding taxation year or fiscal period referred to in paragraph 95(2)(*k*), as the case may be, (which preceding taxation year or preceding fiscal period is referred to as the "preceding taxation year") in which the affiliate is deemed to have disposed of property.

Third, the proposed amendments to subsection 5907(2.9) modify the manner in which any necessary decreases are made to the affiliate's relevant surplus account. As noted above, existing subsection 5907(2.9) provides for the decreases to surplus to be made by way of decreases to "earnings". Amended subsection 5907(2.9) provides, instead, for those amounts to be placed in the "loss" (as defined in subsection 5907(1)) of the affiliate, which result in corresponding decreases in the balance of the surplus account.

Fourth, amended subsection 5907(2.9) contains new rules in respect of eligible capital property and resource property to deal more appropriately with these types of property. As mentioned above, existing subsection 5907(2.9) ensures that where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of property that was used or held by the affiliate in the course of carrying on the foreign business, the affiliate's "earnings" are increased by the total of all amounts each of which is the amount by which the fair market value of the property (other than capital property) to the affiliate exceeds the cost of the property. (There is a corresponding rule in existing subsection 5907(2.9) that provides for a decrease of "earnings" if the cost of the property to the affiliate exceeds the fair market value of the property.)

As proposed to be amended, subsection 5907(2.9) ensures that where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of eligible capital property, the affiliate's "earnings" are increased by the amount, if any, required by subsection 14(1) of the Act to be included in computing the operator's income for that preceding taxation year from the foreign business. Conversely, amended subsection 5907(2.9) also ensures that, if the operator was, because of paragraphs 95(2)(*k*.1) and 138(11.91)(*e*) of the Act, deemed to have, at the end of that preceding taxation year, disposed of eligible capital property, the affiliate's "loss" is increased by the amount, if any, that would be permitted by paragraph 24(1)(*a*) of the Act to be deducted in computing the operator's income for that year from the foreign business if the operator had, immediately before the end of that year, ceased to carry on the foreign business.

For more detail about the treatment of the untaxed portion of the gain or loss from the sale of excluded property that is eligible capital property, refer to the commentaries on new paragraph (*a*.1) of the definition "exempt earnings", and new paragraph (*a*.1) of the definition "exempt loss", respectively, in subsection 5907(1) of the Regulations.

Amended subsection 5907(2.9) ensures that where, because of paragraphs 95(2)(*k*) and 138(11.91)(*e*) of the Act, there is a deemed disposition of resource property, the affiliate's "earnings" are increased by the amount, if any, by which

- the total of all amounts included by subsection 59(1) or paragraph 59(3.2)(*c*) or (*c*.1) of the Act in computing the operator's income for that preceding taxation year from the active business

exceeds

- the total of all amounts that were deductible under section 66, 66.1, 66.2, 66.21 or 66.4 of the Act in computing the operator's income for that year from the active business.

Note that there is a corresponding rule in amended subsection 5907(2.9) for an inclusion in "loss" in the converse situation.

Fifth, proposed amendments to subsection 5907(2.9) provide a rule for the determination, where the operator is the partnership, of the amounts required by that subsection to be added to the affiliate's "earnings" or "loss", as the case may be, for the preceding taxation year. The amount of the increase to the affiliate's "earnings" or "loss" is essentially the amount of the increase to the "earnings" or "loss" for the partnership multiplied by the fraction the numerator of which is the affiliate's share of the income or loss of the partnership for that year and the denominator of which is the income or loss of the partnership for that year. For the purpose of this calculation, where both the income and the loss of the partnership for that preceding year are nil, the partnership is assumed to have an income of $1 million for that year.

The amendments to subsection 5907(2.9) of the Regulations are proposed to apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that these amendments are included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

ITR
5907(2.91)

Proposed new subsection 5907(2.91) of the Regulations is consequential to the introduction of new paragraphs 95(2)(*k*.1) and (*k*.3) of the Act. New subsection 5907(2.91) provides that, for the purposes of section 5907 of the Regulations, any property of a foreign affiliate of a corporation resident in Canada, or of a partnership of which a foreign affiliate of a corporation resident in Canada is a member, that is, for the purposes of subdivision i of Division B of Part I of the Act, deemed because of either paragraph 95(2)(*k*.1) or (*k*.3), and paragraph 138(11.91)(*e*), of the Act to have been disposed of and reacquired by the affiliate or the partnership, as the case may be, is, for the purpose of section 5907 of the Regulations, deemed to have been disposed of and reacquired by the affiliate or the partnership, as the case may be, in the same manner and for the same amounts as if those provisions applied for the purpose of section 5907 of the Regulations.

Subsection 5907(2.91) ensures that the deemed disposition and reacquisition are taken into account when calculating a foreign affiliate's surplus accounts.

New subsection 5907(2.91) of the Regulations is proposed to apply to taxation years, of a foreign affiliate of a taxpayer, that begin after Announcement Date. Note that this amendment is included in the Fresh Start Section 95 Election package described at the beginning of the commentary to section 95 of the Act.

ITR
5907(5)

Subsection 5907(5) of the Regulations provides that, for the purposes of section 5907 of the Regulations, capital gains and losses of a foreign affiliate of a taxpayer from the disposition of property are to be computed in accordance with the rules set out in subsection 95(2) of the Act. In particular, paragraph 95(2)(*f*) of the Act provides special rules for the purposes of computing capital gains and losses of a foreign affiliate of a taxpayer.

Subsection 5907(5) is proposed to be amended in two ways.

First, amended subsection 5907(5) is proposed to be amended to ensure that, where subsection 5907(5.1) has deemed a prior disposition to have taken place at a cost other than fair market value, subsection 5907(5) will not deem the prior disposition to have taken place at fair market value. Accordingly, subsection 5907(5) is made subject to subsection 5907(5.1) so that the gain for the purposes of calculating the surplus accounts will take into account the rules in subsection 5907(5.1).

Second, it is proposed that subsection 5907(5) be amended to make it clear that, subject to subsection 5907(5.1), taxable capital gains and allowable capital losses (as well as capital gains and capital losses) of a foreign affiliate of a taxpayer from the disposition of property are to be computed in accordance with the rules set out in subsection 95(2) of the Act.

The amendments to subsection 5907(5) are proposed to apply to dispositions made after Announcement Date.

ITR
5907(5.1)

Subsection 5907(5.1) of the Regulations generally applies in the case where the following circumstances exist:

- a particular foreign affiliate of a taxpayer resident in Canada disposes of a particular property to a transferee that is either
    - another foreign affiliate of the taxpayer, or
    - a foreign affiliate of another person with whom the taxpayer does not deal at arm's length;
- the particular property is capital property used or held by the particular affiliate principally for the purpose of gaining or producing income from an active business in a country other than Canada; and
- under the income tax law of a country other than Canada that is relevant in computing the earnings of the particular affiliate from an active business carried on by the particular affiliate in a country, no gain or loss is recognized in respect of the disposition.

Subsection 5907(5.1) ensures that, in such circumstances, no surplus is created on the disposition. This is accomplished by deeming the transferor's proceeds (paragraph 5907(5.1)(*a*)), and the transferee's cost (paragraph 5907(5.1)(*b*)), to be equal to the adjusted cost base, to the transferor, of the property immediately before the disposition plus any outlays or expenses incurred by the transferor for the purpose of making the disposition.

Subsection 5907(5.1) is proposed to be amended in the following ways.

First, the "preamble" of subsection 5907(5.1) is amended

- to ensure that the transferor can be either
  - a foreign affiliate of a taxpayer resident in Canada, or
  - a partnership of which a foreign affiliate of a taxpayer resident in Canada is a member;
- to ensure that the disposition can be to any transferee (including any person, corporation or trust);
- to ensure that the property disposed of can be any property that is an "excluded property" (as defined in subsection 95(1) of the Act); and
- to eliminate the requirement that, under the income tax law of a country other than Canada that is relevant in computing the earnings of the particular affiliate from an active business carried on by the particular affiliate in a country, no gain or loss is recognized in respect of the disposition. (The elimination of this requirement will ensure that subsection 5907(5.1) can apply in the case where there is no income tax law in the relevant foreign country.)

Second, new paragraphs 5907(5.1)(*d*) and (*e*) are proposed to introduce new rules in subsection 5907(5.1).

New paragraph 5907(5.1)(*d*) deems the cost to the transferor of a particular property (other than an "interest in the transferee", or a property the cost of which is, because subsection 5907(5.1) applies to the transferee in respect of the disposition of that property, determined under paragraph 5907(5.1)(*b*)) that became receivable by the transferor as consideration for the disposition to be the fair market value of the particular property at the time of the disposition.

In connection with the expression "interest in the transferee", see the commentary on new subsection 5907(5.2).

New subsection 5907(5.3) is also relevant for the purposes of applying subsection 5907(5.1). For more detail, see the commentary to subsections 5907(5.3).

Example

The following example illustrates the application of the exclusion, in paragraph 5907(5.1)(d), in respect of "a property the cost of which is, because subsection 5907(5.1) applies to the transferee in respect of the disposition of that property, determined under paragraph 5907(5.1)(b)".

Facts:

1. Corporation A disposes of a property (Property A) to Corporation B.

2. Assume that Property A is an excluded property. Also assume that subsection 5907(5.1) of the Regulations applies to the disposition of Property A. Thus, in applying subsection 5907(5.1) to the disposition of Property A, Corporation A is the "transferor" and Corporation B is the "transferee".

3. In consideration for the disposition of Property A, Corporation B disposes of a property (Property B) to Corporation A.

4. Assume that Property B is an excluded property. Also assume that subsection 5907(5.1) applies to the disposition of Property B. Thus, in applying subsection 5907(5.1) to the disposition of Property B, Corporation B is the "transferor" and Corporation A is the "transferee".

Results:

This exclusion in paragraph 5907(5.1)(d) ensures the following:

- *The cost, to Corporation A, of Property B is the amount determined by paragraph 5907(5.1)(b) to be cost, of Property B, to Corporation A as transferee under the disposition of Property B. To make this determination, apply subsection 5907(5.1) so that disposition of Property B is the principal disposition, Corporation B is the "transferor" and Corporation A is the "transferee".*

- *The cost, to Corporation B, of Property A is the amount determined by paragraph 5907(5.1)(b) to be cost, of Property A, to Corporation B as transferee under the disposition of Property A. To make this determination, apply subsection 5907(5.1) so that disposition of Property A is the principal disposition, Corporation A is the "transferor" and Corporation B is the "transferee".*

New paragraph 5907(5.1)(*e*) determines the cost of the interest in a transferee received by the transferor as consideration for the excluded property transferred. The cost is determined by the formula

$$(A - B) \times C/D$$

where

A is the transferor's proceeds of disposition of the excluded property,

B is the cost to the transferor of a property (other than an "interest in the transferee", or a property the cost of which is, because this subsection applies to the transferee in respect of the disposition of that property, determined under paragraph 5907(5.1)(*b*)) that became receivable by the transferor as consideration for the disposition,

C is the fair market value, immediately after the disposition, of the "interest in the transferee" received as consideration for the excluded property, and

D is the fair market value, immediately after the disposition, of all "interests in the transferee" received as consideration for the excluded property.

The amendments to subsection 5907(5.1) are proposed to apply to dispositions made after Announcement Date.

ITR
5907(5.2)

Section 5907 of the Regulations is proposed to be amended by adding new subsection 5907(5.2).

New subsection 5907(5.2) provides that an "interest in the transferee" referred to in subsection 5907(5.1) is

- if the transferee is a corporation, a share of the capital stock of the corporation,

- if the transferee is a partnership, an interest in the partnership, and

- if the transferee is a trust, a beneficial interest in the trust.

New subsection 5907(5.2) is proposed to apply to dispositions made after Announcement Date.

ITR
5907(5.3)

Section 5907 of the Regulations is proposed to be amended by adding new subsection 5907(5.3).

New subsection 5907(5.3) ensures that subsection 5907(5.1) does not apply to a disposition of property if

- the gain or loss, if any, in respect of the disposition was included in computing an amount that was taxable under the income tax law, of a country other than Canada, that is relevant in computing the earnings of the affiliate from an active business carried on by it, or
- subsection 88(3), or paragraph 95(2)(*c*), (*d*) or (*e*), of the Act applied in respect of the disposition.

New subsection 5907(5.3) is proposed to apply to dispositions made after Announcement Date.

ITR
5907(9)

Where a foreign affiliate of a taxpayer resident in Canada has been dissolved and paragraph 95(2)(*e*.1) of the Act does not apply, subsection 5907(9) of the Regulations provides that certain rules apply for the purposes of computing the various amounts referred to in section 5907 of the Regulations.

The "preamble" of subsection 5907(9) of the Regulations is proposed to be amended so that the rules provided for in subsection 5907(9) do not apply where a foreign affiliate of a taxpayer resident in Canada has been dissolved as a result of a foreign merger within the meaning assigned by subsection 87(8.1) of the Act.

This amendment is proposed to apply to dissolutions that begin after Announcement Date.

APPENDIX E

DRAFT INCOME TAX REGULATIONS AND EXPLANATORY NOTES

Foreign Oil and Gas Business

1. Part LIX of the *Income Tax Regulations* is amended by adding the following after section 5909:

FOREIGN OIL AND GAS BUSINESS

5910. (1) If a foreign affiliate of a corporation carries on a foreign oil and gas business in a taxing country in a taxation year of the affiliate, the affiliate is deemed for the purposes of this Part to have paid for the year as an income or profits tax to the government of the taxing country an amount equal to the lesser of

(*a*) the amount, if any, by which

> (i) 40% of the amount that would, if the definition "earnings" in subsection 5907(1) were read without reference to its subparagraphs (*a*)(i) and (ii), be the affiliate's earnings from the business in the taxing country for the year

exceeds

> (ii) the total of all amounts that would, but for this subsection, be income or profits taxes paid by the affiliate for the year in respect of the business to the government of the taxing country, and

(*b*) the affiliate's production tax amount for the business in the taxing country for the year.

(2) In subsection 1, "foreign oil and gas business," "production tax amount" and "taxing country" have the meanings assigned by subsection 126(7) of the Act.

2. Section 1 applies in respect of production tax amounts that become receivable by the government of a taxing country in taxation years, of a taxpayer's foreign affiliate, that begin after the earlier of December 31, 2002 and the designated date. The designated date is the later of

(*a*) December 31, 1994; and

(*b*) any date that the taxpayer designates in writing for the purpose of this section, if the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's first taxation year that ends after 2002.

FOREIGN OIL AND GAS BUSINESS

EXPLANATORY NOTES

Announced in the 2000 Budget and enacted in 2001, subsection 126(5) of the *Income Tax Act* deems certain foreign oil and gas levies to be income or profits taxes for purposes of the foreign tax credit rules. Proposed section 5910 of the *Income Tax Regulations* extends this treatment to the foreign affiliate rules. As a result, the levies can, in certain cases, be included in computing the foreign tax paid by a foreign affiliate.

More specifically, where a foreign affiliate of a corporation carries on a "foreign oil and gas business" in a "taxing country" in the year, subsection 5910(1) of the Regulations will deem the affiliate to have paid for the year as an income or profits tax, the lesser of two amounts. The first amount (paragraph 5910(1)(*a*)) is the amount by which 40% of the affiliate's "earnings" from the business, read without reference to subparagraphs (*a*)(i) and (ii) of that definition, exceeds the amounts that would otherwise have been income or profits taxes that were paid by the affiliate to the country in respect of the business for the year. The second amount (paragraph 5910(1)(*b*)) is the affiliate's "production tax amount" for the business for the year. Subsection 5910(2) provides that for the purpose of section 5910, "foreign oil and gas business," "production tax amount" and "taxing country" have the meanings assigned by subsection 126(7) of the Act.

This amendment applies in respect of production tax amounts that became receivable by the government of a taxing country in taxation years, of a taxpayer's foreign affiliate, that begin after the earlier of

(*a*) December 31, 2002; and

(*b*) where the taxpayer designates a date in writing and the designation is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's first taxation year that ends after 2002, the later of

(i) the designated date, and

(ii) December 31, 1994.

APPENDIX F

DRAFT *INCOME TAX REGULATIONS*
AND EXPLANATORY NOTES

Flow-Through Shares – Prescribed Right

1. (1) The portion of subparagraph 6202.1(1)(*a*)(iii) of the *Income Tax Regulations* after subclause (A)(I) is replaced by the following:

(II) a right (including a right conferred by a warrant) that

1. if it were issued, would not be a prescribed right, and

2. if it were exercised, would allow the person exercising it to acquire only a share of the corporation that, if the share were issued, would not be a prescribed share, or

(III) both a share described in subclause (I) and a right described in subclause (II), and

(B) all the consideration receivable by the holder on the conversion or exchange of the share is the share described in subclause (A)(I) or the right described in subclause (A)(II), or both, as the case may be, or

(2) Section 6202.1 of the Regulations is amended by adding the following after subsection (1):

(1.1) For the purpose of the definition "flow-through share" in subsection 66(15) of the Act, a new right to acquire a share of the capital stock of a corporation is a prescribed right if, at the time the right is issued,

(*a*) the amount that the holder of the right is entitled to receive in respect of the right on the dissolution, liquidation or winding-up of the corporation or on the redemption, acquisition or cancellation of the right by the corporation or by specified persons in relation to the corporation (referred to in this section as the "liquidation entitlement" of the right) can reasonably be considered to be, by way of a formula or otherwise, fixed, limited to a maximum or established to be not less than a minimum;

(*b*) the right is convertible or exchangeable into another security issued by the corporation unless

  (i) the right is convertible or exchangeable only into

    (A) a share of the corporation that, if issued, would not be a prescribed share,

    (B) another right (including a right conferred by a warrant) that

      (I) if it were issued, would not be a prescribed right, and

      (II) if it were exercised, would allow the person exercising it to acquire only a share of the corporation that, if the share were issued, would not be a prescribed share, or

    (C) both a share described in clause (A) and a right described in clause (B), and

  (ii) all the consideration receivable by the holder on the conversion or exchange of the right is the share described in clause (A) or the right described in clause (B), or both, as the case may be;

(*c*) any person or partnership has, either absolutely or contingently, an obligation (other than an excluded obligation in relation to the right)

  (i) to provide assistance,

  (ii) to make a loan or payment,

  (iii) to transfer property, or

  (iv) to otherwise confer a benefit by any means whatever, including the payment of a dividend,

either immediately or in the future, that can reasonably be considered to be, directly or indirectly, a repayment or return by the corporation or a specified person in relation to the corporation of all or part of the consideration for which the right was issued or for which a partnership interest was issued in a partnership that acquires the right;

(*d*) any person or partnership has, either absolutely or contingently, an obligation (other than an excluded obligation in relation to the right) to effect any undertaking, either immediately or in the future, with respect to the right or the agreement under which the right is issued (including any guarantee, security, indemnity, covenant or agreement and including the lending of funds to or the placing of amounts on deposit with, or on behalf of, the holder of the right or where the holder is a partnership, the members of the partnership or specified persons in relation to the holder or the members of the partnership, as the case may be) that can reasonably be considered to have been given to ensure, directly or indirectly, that

(i) any loss that the holder of the right and, where the holder is a partnership, the members of the partnership or specified persons in relation to the holder or the members of the partnership, as the case may be, may sustain because of the holding, ownership or disposition of the right or any other property is limited in any respect, or

(ii) the holder of the right and, where the holder is a partnership, the members of the partnership or specified persons in relation to the holder or the members of the partnership, as the case may be, will derive earnings, because of the holding, ownership or disposition of the right or any other property;

(*e*) the corporation or a specified person in relation to the corporation can reasonably be expected

(i) to acquire or cancel the right in whole or in part otherwise than on a conversion or exchange of the right that meets the conditions set out in subparagraphs (*b*)(i) and (ii), or

(ii) to make a payment, transfer or other provision (otherwise than pursuant to an excluded obligation in relation to the right), directly or indirectly, by way of a dividend, loan, purchase of shares, financial assistance to any purchaser of the right or, where the purchaser is a partnership, the members of the partnership or in any other manner whatever, that can reasonably be considered to be a repayment or return of all or part of the consideration for which the right was issued or for which a partnership interest was issued in a partnership that acquires the right, within 5 years after the day the right is issued, otherwise than as a consequence of an amalgamation of a subsidiary wholly-owned corporation, a winding-up of a subsidiary wholly-owned corporation to which subsection 88(1) of the Act applies or the payment of a dividend by a subsidiary wholly-owned corporation to its parent;

(*f*) any person or partnership can reasonably be expected to effect, within 5 years after the day the right is issued, any undertaking which, if it were in effect at the time the right was issued, would result in the right being a prescribed right because of paragraph (*d*);

(*g*) it can reasonably be expected that, within 5 years after the day the right is issued,

(i) any of the terms or conditions of the right or any existing agreement relating to the right or its issue will be modified, or

(ii) any new agreement relating to the right or its issue will be entered into,

in such a manner that the right would be a prescribed right if it had been issued at the time of the modification or at the time the new agreement is entered into; or

(*h*) it can reasonably be expected that the right, if exercised, would allow the person exercising the right to acquire a share in a corporation that, if that share were issued, would become a prescribed share within 5 years after the day the right was issued.

(3) Section 6202.1 of the Regulations is amended by adding the following after subsection (2):

(2.1) For the purpose of the definition "flow-through share" in subsection 66(15) of the Act, a new right is a prescribed right if

(*a*) the consideration for which the new right is to be issued is to be determined more than 60 days after entering into the agreement pursuant to which the new right is to be issued;

(*b*) the corporation or a specified person in relation to the corporation, directly or indirectly,

(i) provided assistance,

(ii) made or arranged for a loan or payment,

(iii) transferred property, or

(iv) otherwise conferred a benefit by any means whatever, including the payment of a dividend,

for the purpose of assisting any person or partnership to acquire the new right or any person or partnership to acquire an interest in a partnership acquiring the new right (otherwise than because of an excluded obligation in relation to the new right); or

(*c*) the holder of the new right or, where the holder is a partnership, a member of the partnership, has a right under any agreement or arrangement entered into under circumstances where it is reasonable to consider that the agreement or arrangement was contemplated at or before the time the agreement to issue the new right was entered into,

(i) to dispose of the new right, and

(ii) through a transaction or event or a series of transactions or events contemplated by the agreement or arrangement, to acquire

(A) a share (referred to in this paragraph as the "acquired share") of the capital stock of another corporation that would be a prescribed share under subsection (1) if the acquired share were issued at the time the new right was issued, other than a share that would not be a prescribed share if subsection (1) were read without reference to subparagraphs (1)(*a*)(iv) and (1)(*d*)(i) and (ii) where the acquired share is a share

(I) of a mutual fund corporation, or

(II) of a corporation that becomes a mutual fund corporation within 90 days after the acquisition of the acquired share, or

(B) a right (referred to in this paragraph as the "acquired right") to acquire a share of the capital stock of another corporation that would, if it were issued at the time the new right was issued, be a prescribed right, other than a right that would not be a prescribed right if subsection (1.1) were read without reference to subparagraphs (1.1)(*e*)(i) and (ii) where the acquired right is a right to acquire a share of the capital stock

(I) of a mutual fund corporation, or

(II) of a corporation that becomes a mutual fund corporation within 90 days after the acquisition of the acquired right.

(4) Subsections 6202.1(3) and (4) of the Regulations are replaced by the following:

(3) For the purposes of subsections (1) and (1.1),

(*a*) the dividend entitlement of a share of the capital stock of a corporation is deemed not to be fixed, limited to a maximum or established to be not less than a minimum where all dividends on the share are determined solely by reference to a multiple or fraction of the dividend entitlement of another share of the capital stock of the corporation, or of another corporation that controls the corporation, where the dividend entitlement of that other share is not described in subparagraph (1)(*a*)(i); and

(*b*) the liquidation entitlement of a share of the capital stock of a corporation, or of a right to acquire a share of the capital stock of the corporation, as the case may be, is deemed not to be fixed, limited to a maximum or established to be not less than a minimum where

(i) all the liquidation entitlement is determinable solely by reference to

(A) the liquidation entitlement of another share of the capital stock of the corporation (or a share of the capital stock of another corporation that controls the corporation), or

(B) the liquidation entitlement of a right to acquire the capital stock of the corporation (or another corporation that controls the corporation),

(ii) the liquidation entitlement described in clause (i)(A), if any, is not described in subparagraph (1)(*a*)(ii), and

(iii) the liquidation entitlement described in clause (i)(B), if any, is not described in subparagraph (1.1)(*a*)(i).

(4) For the purposes of paragraphs (1)(*c*) and (*e*) and (1.1)(*d*) and (*f*), an agreement entered into between the first holder of a share or right and another person or partnership for the sale of the share or

right to that other person or partnership for its fair market value at the time the share or right is acquired by the other person or partnership (determined without regard to the agreement) is deemed not to be an undertaking with respect to the share or right, as the case may be.

(5) The definition "excluded obligation" in subsection 6202.1(5) of the Regulations is replaced by the following:

"excluded obligation", in relation to a share or new right issued by a corporation, means

(*a*) an obligation of the corporation

(i) with respect to eligibility for, or the amount of, any assistance under the *Canadian Exploration and Development Incentive Program Act*, the *Canadian Exploration Incentive Program Act*, the *Ontario Mineral Exploration Program Act, 1989*, Statutes of Ontario 1989, c. 40, or the *Mineral Exploration Incentive Program Act (Manitoba)*, Statutes of Manitoba 1990-91, c. 45, or

(ii) with respect to the making of an election respecting such assistance and the flowing out of such assistance to the holder of the share or the new right in accordance with any of those Acts,

(*b*) an obligation of the corporation, in respect of the share or the new right, to distribute an amount that represents a payment out of assistance to which the corporation is entitled

(i) as a consequence of the corporation making expenditures funded by consideration received for shares or new rights issued by the corporation in respect of which the corporation purports to renounce an amount under subsection 66(12.6) of the Act, and

(ii) under section 25.1 of the *Income Tax Act*, Revised Statutes of British Columbia, 1996, c. 215, or

(*c*) an obligation of any person or partnership to effect an undertaking to indemnify a holder of the share or the new right or, where the holder is a partnership, a member of the partnership, for an amount not exceeding the amount of any tax payable under the Act or the laws of a province by the holder or the member of the partnership, as the case may be, as a consequence of

(i) the failure of the corporation to renounce an amount to the holder in respect of the share or the new right, or

(ii) a reduction, under subsection 66(12.73) of the Act, of an amount purported to be renounced to the holder in respect of the share or the new right;

(6) Subsection 6202.1(5) of the Regulations is amended by adding the following definition in alphabetical order:

"new right" means a right that is issued after ANNOUNCEMENT DATE to acquire a share of the capital stock of a corporation, other than a right that is issued at a particular time before 2003,

(*a*) pursuant to an agreement in writing made on or before ANNOUNCEMENT DATE,

(*b*) as part of a distribution of rights to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before distribution of the rights begins, filed on or before ANNOUNCEMENT DATE with a public authority in Canada in accordance with the securities legislation of the province in which the rights are distributed, or

(*c*) to a partnership interests in which were issued as part of a distribution to the public made in accordance with the terms of a prospectus, preliminary prospectus, registration statement, offering memorandum or notice, required by law to be filed before distribution of the interests begins, filed on or before ANNOUNCEMENT DATE with a public authority in Canada in accordance with the securities legislation of the province in which the interests are distributed, where all interests in the partnership issued at or before the particular time were issued

(i) as part of the distribution, or

(ii) before the beginning of the distribution;

2. Section 1 applies to shares and rights issued under an agreement made after ANNOUNCEMENT DATE.

FLOW-THROUGH SHARES – PRESCRIBED RIGHT

EXPLANATORY NOTES

ITR
6202.1

Section 6202.1 of the *Income Tax Regulations* defines certain shares ("prescribed shares") for the purpose of the definition "flow-through share" in subsection 66(15) of the Act. A prescribed share does not qualify as a flow-through share. The purpose of these rules is to ensure that flow-through shares represent genuine risk capital.

Generally speaking, a share will be a prescribed share if the share has fixed or limited rights to dividends or an obligation exists to reduce the paid-up capital of the share or to confer a benefit or guarantee in respect of the share. The restrictions imposed on shares do not apply to rights to acquire shares.

Section 6202.1 is amended, applicable to shares and rights issued under an agreement made after Announcement Date, to include a definition of a prescribed right. A "prescribed right" is defined in new subsections 6202.1(1.1) and (2.1). This amendment ensures that restrictions on the type of shares that may qualify as flow-through shares currently found in subsections 6202.1(1) and (2) also apply to rights to acquire shares.

APPENDIX G

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Prescribed Share

1. Paragraph 6204(1)(*b*) of the *Income Tax Regulations* is replaced by the following:

> (*b*) the corporation or a specified person in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, as the case may be, redeem, acquire or cancel the share in whole or in part, or reduce the paid-up capital of the corporation in respect of the share, otherwise than as a consequence of
>
> (i) an amalgamation of a subsidiary wholly-owned corporation,
>
> (ii) a winding-up to which subsection 88(1) of the Act applies, or
>
> (iii) a distribution or appropriation to which subsection 84(2) of the Act applies; and

2. Section 1 applies to options exercised after 1998.

PRESCRIBED SHARE

EXPLANATORY NOTES

ITR
6204(1)(*b*)

Subsection 6204(1) of the *Income Tax Regulations* sets out certain conditions that must be met by a share, acquired by an employee under a stock option agreement referred to in subsection 7(1) of the *Income Tax Act*, to be a prescribed share eligible for the stock option deduction under paragraph 110(1)(*d*) of the Act. One of the conditions, set out in paragraph 6204(1)(*b*) of the Regulations, is that there be no reasonable expectation, at the time the share is acquired by the employee, that the paid-up capital (PUC) of the share will be reduced in the following two years. However, exceptions are made for reductions in PUC that may be expected to occur as a consequence of an amalgamation of a subsidiary wholly-owned corporation or of a winding-up to which subsection 88(1) of the Act applies.

Paragraph 6204(1)(*b*) is to be amended to include in the exceptions a reduction in PUC that may be expected to occur as a consequence of a distribution or appropriation of funds or property to which subsection 84(2) of the Act applies. This will ensure that an employee who acquires a stock option share of a Canadian-resident corporation, while the corporation is in the process of a reorganization, discontinuance or winding-up, is not precluded from claiming the stock option deduction by reason only that that activity may give rise to a reasonable expectation of a distribution by the corporation and an associated reduction in PUC.

The amendment to paragraph 6204(1)(*b*) of the Regulations is to apply to options that are exercised after 1998.

APPENDIX H

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Prescribed Venture Capital Corporations

1. Section 6700 of the *Income Tax Regulations* is amended by adding the following after paragraph (*e*):

(*e*.1) the corporation established by *An Act constituting Capital régional et coopératif Desjardins*, R.S.Q., c. C–6.1.

2. Section 6704 of the Regulations is amended by striking out the word "or" at the end of paragraph (*c*), by adding the word "or" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*e*) an investment in an eligible entity described in sections 17 and 18 of *An Act constituting Capital régional et coopératif Desjardins*, R.S.Q.,c. C–6.1.

3. Sections 1 and 2 apply to the 2001 and subsequent taxation years.

PRESCRIBED VENTURE CAPITAL CORPORATIONS

EXPLANATORY NOTES

ITR
6700

Section 6700 of the Regulations is to be amended to include in the list of corporations that are prescribed venture capital corporations a corporation established by *An Act constituting Capital régional et coopératif Desjardins*, R.S.Q., c. C-6.1.

ITR
6704

Section 6704 of the Regulations sets out the criteria for determining if a corporation is a "prescribed qualifying corporation" in respect of dividends received by a shareholder on shares of its capital stock for the purposes of section 186.2 of the Act. Section 6704 is to be amended to include a corporation whose shares, at the time that they are acquired by a shareholder, are an investment in an eligible entity described in *An Act constituting Capital régional et coopératif Desjardins*, R.S.Q., c. C-6.1 as a "qualifying corporation".

The amendments to sections 6700 and 6704 of the Regulations are to apply to the 2001 and subsequent taxation years.

APPENDIX I

DRAFT *INCOME TAX REGULATIONS*
AND EXPLANATORY NOTES

Deferred Profit Sharing Plans

1. Subsection 8301(2) of the *Income Tax Regulations* is replaced by the following:

PENSION CREDIT – DEFERRED PROFIT SHARING PLAN

(2) For the purposes of subsection (1) and Part LXXXV and subsection 147(5.1) of the Act, and subject to subsection 8304(2), an individual's pension credit for a calendar year with respect to an employer under a deferred profit sharing plan is the amount determined by the formula

$$A - B$$

where

A is the total of all amounts each of which is

(*a*) a contribution made to the plan in the year by the employer with respect to the individual, or

(*b*) the portion of an amount allocated in the year to the individual that is attributable to forfeited amounts under the plan or to earnings of the plan in respect of forfeited amounts, except to the extent that the portion

(i) is included in determining the individual's pension credit for the year with respect to any other employer who participates in the plan, or

(ii) is paid to the individual in the year; and

B is nil, unless the conditions in subsection (2.1) are satisfied, in which case it is the total referred to in paragraph (2.1)(*b*).

CONDITIONS RE – DESCRIPTION OF B IN SUBSECTION (2)

(2.1) The following are conditions for the purpose of the description of B in subsection (2):

(*a*) the total of all amounts, each of which would be the individual's pension credit for the calendar year with respect to the employer under a deferred profit sharing plan if the description of B in subsection (2) were read as "is nil.", is

(i) equal to, or less than, 50% of the money purchase limit for the year,

(ii) greater than 18% of the amount that would be the individual's compensation from the employer for the year if the definition "compensation" in subsection 147.1(1) of the Act were read without reference to paragraph (*b*) of that definition, and

(iii) equal to, or less than, 18% of the amount that would be the individual's compensation from the employer for the preceding year if the definition "compensation" in subsection 147.1(1) of the Act were read without reference to paragraph (*b*) of that definition; and

(*b*) the total of all amounts, each of which is an amount that is paid from the plan to the individual or the employer in the calendar year or in the first two months of the following year that can reasonably be considered to derive from an amount included in the value of A in subsection (2) with respect to the individual and the employer for the year, is greater than nil.

(2) Subsection 8301(15) of the Regulations is replaced by the following:

TRANSFERRED AMOUNTS

(15) For the purposes of subparagraph (*b*)(ii) of the description of A in subsection (2), paragraph (2.1)(*b*) and subparagraph (4)(*b*)(iv), an amount transferred for the benefit of an individual from a registered pension plan or a deferred profit sharing plan directly to a

registered pension plan, a registered retirement savings plan, a registered retirement income fund or a deferred profit sharing plan is deemed to be an amount that was not paid to the individual.

2. Section 1 applies to the determination of pension credits for the 2002 and subsequent calendar years.

DEFERRED PROFIT SHARING PLANS

EXPLANATORY NOTES

Pension Credit – Deferred Profit Sharing Plans

ITR
8301(2) and (2.1)

Subsection 147(5.1) of the Act sets out various limits for deferred profit sharing plans (DPSPs). The most significant limit, in terms of this amendment to subsection 8301(2) of the *Income Tax Regulations*, is the one in paragraph 147(5.1)(*a*). In general terms, that paragraph requires that an individual's total DPSP pension credits for a year in respect of an employer not exceed the lesser of: (i) 18% of the individual's compensation from the employer for the year; and (ii) 1/2 of the money purchase limit for the year. For this purpose, “compensation” and “money purchase limit” are generally as defined in subsection 147.1(1) of the Act. If these limits are exceeded, the registration of the plan can be revoked and the employer is denied a deduction for all contributions made in the year, except as expressly permitted in writing by the Minister of National Revenue.

Subsection 8301(2) of the Regulations defines the pension credit of an individual for a calendar year in respect of an employer under a DPSP to be the total of:

- all contributions made to the plan by the employer in the year in respect of the individual; and

- forfeited amounts under the plan, and investment earnings attributable to those amounts, that are reallocated in the year to the individual (and not paid out of the plan to the individual in the year).

It is common practice for an employer to make contributions to a DPSP only after its fiscal year-end, since this is when profits are determined. This can often result in employer contributions being made based (in whole or in part) on employees' earnings in the previous calendar year, but being included in the employees' pension credits for the current calendar year. This will in turn give rise to excess DPSP contributions if an employee's compensation for the current year is for some reason insufficient to support the pension credit. This could occur, for example, where the contributions are made early in the year and the employee goes on leave without pay later in the year.

The proposed amendment to subsection 8301(2) provides a mechanism to deal with over-contributions that arise in these situations. It allows the over-contributions to be ignored for purposes of determining an individual's DPSP pension credit, provided the excess is refunded from the plan in the year or before the end of February of the following year. The amendment also applies to provide relief in similar over-contribution situations, involving employees who terminate employment, that were previously dealt with by repealed subsection 147(5.11) of the Act.

More specifically, amended subsection 8301(2) provides that an individual's pension credit for a calendar year in respect of an employer under a DPSP is the amount determined by the following formula

$$A - B$$

Variable A in the formula is the total employer contributions and forfeited amounts made or reallocated in the year in respect of the individual. This amount corresponds to the pension credit determined under former subsection 8301(2).

Variable B is relevant only where the total employer contributions and forfeited amounts made or reallocated in the year with respect to the individual would not otherwise satisfy the DPSP contribution limit in paragraph 147(5.1)(*a*), but would have satisfied that limit if it had been based on the individual's compensation for the previous calendar year. (These conditions are set out in new subsection 8301(2.1).) In this case, variable B is equal to the total of all payments made from the plan to the individual or the employer in the year or in the first two months of the following year, to the extent that the payments can be considered to derive from amounts included in determining the value of A.

> *Example*
>
> *An employer makes a DPSP contribution for its employees in March 2003 based on profits for its fiscal period that ended on January 31, 2003. \$5,000 of the contribution is allocated to Isaac, who earned \$60,000 in 2002. Isaac takes a one-year unpaid leave of absence starting in April 2003, after having earned \$15,000 in the first three months of 2003. To avoid exceeding the DPSP contribution limits in subsection 147(5.1), the DPSP trustee refunds the \$2,300 excess amount (\$5,000 - 18% of \$15,000) to the employer in February 2004.*
>
> *Isaac's pension credit for 2003 is \$2,700 (\$5,000 contribution - \$2,300 refund).*

Subsection 8301(15) of the Regulations provides that an amount is not considered to be paid to an individual if it is transferred directly to a DPSP, registered pension plan (RPP), registered retirement savings plan (RRSP) or registered retirement income fund (RRIF). Thus, such a transfer from a DPSP will not be included in determining the value of B and consequently will not reduce the individual's pension credit under the DPSP.

This amendment is to apply to the determination of pension credits for the 2002 and subsequent calendar years.

Transferred Amounts

ITR
8301(15)

Paragraphs 8301(2)(*b*) and (4)(*b*) of the Regulations provide that certain amounts allocated to an individual under a DPSP or under a money purchase provision of an RPP are not included in the individual's pension credit if paid to the individual in the year in which they are allocated. For this purpose, subsection 8301(15) of the Regulations deems an amount not to be paid to an individual if it is transferred directly to a DPSP, RPP, RRSP or RRIF. As a consequence, such amounts are included in the individual's pension credit.

Subsection 8301(15) is to be amended to replace the reference to paragraph 8301(2)(*b*) with a reference to subparagraph (*b*)(ii) of the description of A in subsection 8301(2) and to add a reference to new paragraph 8301(2.1)(*b*). This amendment is consequential to a restructuring of subsection 8301(2). For further details, see the commentary to that subsection.

This amendment is to apply to the determination of pension credits for the 2002 and subsequent calendar years.

APPENDIX J

DRAFT INCOME TAX REGULATION AND EXPLANATORY NOTE

Tax on Large Corporations

1. Section 8604 of the *Income Tax Regulations* is repealed.

2. Section 1 applies after ANNOUNCEMENT DATE - 1.

TAX ON LARGE CORPORATIONS

EXPLANATORY NOTE

ITR
8604

Existing section 8604 of the *Income Tax Regulations* prescribes corporations for the purposes of paragraph (*g*) of the definition "financial institution" in subsection 181(1) of the Act. In its paragraph (*a*), section 8604 also provides that a corporation of which all or substantially all of the assets are shares or indebtedness of a financial institution (as defined in subsection 181(1)) to which the corporation is related also falls within the definition.

Section 8604 is proposed to be repealed as a consequence of amendments to paragraph (*g*) of the definition, and readers may consult the notes for the amendments to that paragraph for additional information.

The repeal of this section is proposed to apply on and after Announcement Date.